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IN THE

Supreme Court of the United States

OCTOBER TERM, [redacted] 1969

JANE LEVIN, on Behalf of Herself and All Others Similarly Situated,

Petitioner,

and

MATILDA BURGER, *et al.*,

Common Stockholders-Intervener-Plaintiffs,

and

SAMUEL MEHLMAN, on Behalf of Himself and All Others Similarly Situated,

Preferred Stockholder Intervener-Plaintiffs,

v.

THE GREAT WESTERN SUGAR COMPANY, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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THE GREAT WESTERN SUGAR COMPANY, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the Third Circuit to review the judgment of that Court entered on February 5, 1969, which affirmed an order of the District Court for the District of New Jersey dismissing the action and grant-

ing final judgment in favor of defendants following trial without jury.

Opinions Below

The opinion of the Court of Appeals for the Third Circuit, 406 F.2d 1112 (1969), and its judgment are set forth in Appendix A, *infra,* pp. 1A to 19A, and the opinion of the District Court for the District of New Jersey (not yet reported), appears in Appendix B, *infra,* pp. 21A to 57A.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit sought to be reviewed was entered on February 5, 1969. This Court has jurisdiction under 62 Stat. 928, 28 U.S.C. 1254 (1). Of plaintiff's three causes of action, one arises under the provisions of Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and its implementing Rule 10b-5, 17 CPR Section 240, 10b-5, one is based on pendent jurisdiction, and the third is grounded on diversity of citizenship.

Questions Presented

1. Whether a merger between two corporations, one of which is dominated and controlled by the other, should be set aside as violative of Section 10(b) of the Securities Exchange Act of 1934 in a class action by a minority public stockholder of the dominated company, without regard to the resultant terms of the merger where (a) the dominant company deliberately sought and obtained control of the dominated company through a tender offer with

a view to merger; (b) the dominant company promptly elected its designees (including some of its own officers and directors) as majority directors of the dominated company; (c) the financial interests of the dominant company and of the controlling directors of the dominated company conflicted with the interests of the public stockholders of the dominated company; (d) the public stockholders of the dominated company were denied the benefits of negotiation on their behalf by their Board of Directors or anyone else; (e) the controlling directors of the dominated company used their influence and domination to control the formulation of the merger terms, disregarded the opinion of the independent financial advisers of the dominated company that the plan was unfair to its public stockholders and replaced those advisers, and otherwise failed to comply with their fiduciary obligations to the public stockholders of the dominated company in the formulation and effectuation of the plan?

2. Whether public minority stockholders of a corporation controlled by the other party to a merger may set aside the merger under Section 10(b) of the Securities Exchange Act of 1934, without regard to the resultant terms of the merger, where the necessary votes for such merger were solicited by a proxy statement which failed fully to disclose the conduct of the directors of the dominated company in the formulation and effectuation of the merger plan which departed from the standards imposed by this Court upon fiduciaries—a question substantially similar to that presented in *Mills and Susman* v. *The Electro Autolite Company*, 403 F.2d 429 (1968), in which this Court on April 21, 1969 granted a writ of certiorari to the U.S. Court of Appeals for the Seventh Circuit?

3. Whether a merger between two corporations, where one is dominated and controlled by the other and the conduct of the dominant company and the directors of the dominated company violated their fiduciary duties, should be set aside as violative of Section 10(b) of the Securities Exchange Act of 1934, even if the resultant merger terms are relevant at all, where there is a disparate allocation in favor of the dominant company of the merged company's earnings, dividends, market values and cash flow which establishes more than the slight grounds required to set aside the merger; and whether it is an insufficient defense that the merger terms are merely arguably fair and then only by reliance on "growth orientation" of the management of the much smaller dominant company to justify the disparate allocation of the tangible factors?

4. Whether the matters claimed by petitioner to be violative of Section 10(b) of the Securities Exchange Act of 1934 are also violative of New Jersey state law?

The Statutes and Rules Involved

The relevant provisions of Section 10(b) of the Securities Exchange Act of 1934 and of Rule 10b-5 promulgated thereunder are set forth in Appendix C, *infra*, pp. 59A to 60A.

Statement of the Case

The plaintiff, as a common stock shareholder of the Great Western Sugar Company ("SUGAR"), commenced this class action in June 1967 to enjoin the merger of SUGAR and the Colorado Milling and Elevator Company

("MILLING") into a subsidiary of MILLING, the newly-formed Great Western United Corporation ("UNITED"), and for other relief. The defendants are SUGAR, MILLING and UNITED, the directors of SUGAR and MILLING and others not involved in the appeal.

Plaintiff's complaint (R. 55a-76a)[1] set forth three causes of action. The first was grounded on Section 10(b) of the Securities Exchange Act of 1934 and its implementing Rule 10b-5 and was the primary basis for federal jurisdiction. It alleged that the proposed merger and the conduct of the defendants constituted an unlawful device, scheme, and artifice to defraud and were acts, practices, and courses of business which operated as a fraud and deceit upon plaintiff's class. The second and third causes of action alleged claims under New Jersey state law on substantially the same substantive grounds and rested on pendent jurisdiction and diversity of citizenship.

The merger agreement was approved by the Boards of Directors of the two companies on April 12, 1967. After the District Court dismissed the complaint on January 2, 1968 (*infra* pp. 56A to 57A) following trial, plaintiff sought, and was denied, a restraining Order from the District Court and the Court of Appeals, and on January 16, 1968 the merger was consummated.

SUGAR was the largest sugar beet producer in the United States. MILLING was principally engaged in the manufacture and sale of wheat, flour, and mixes, and animal feed.

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[1] Herein "R." refers to the Appendices filed with the Court of Appeals. Numbers preceded by "Tr." refer to pages of transcript of testimony. Numbers preceded by "P", "DCM", or "DGW" refer to exhibits at trial.

The comparative size and status of the two companies are shown by the following:

1967 Fiscal Year[2]	SUGAR	MILLING
Net Income	$ 9 Million	$ 1.6 Million
Cash Flow	13.2 Million	3 Million
Working Capital	53 Million	12 Million
Net Worth	94 Million	23.5 Million
Total Assets	125 Million	34.1 Million
Earnings per Common Share	4.42	2.94[3]
11-year historical earnings per common share	Rose from $2.19 to $4.42	Rose from $2.70 to $2.94[3]
Dividends per Common Share	2.00	1.20
11-year historical dividends per common share	Rose from $1.50 to $2.00	Fell from $1.40 to $1.20
Ratio of earnings to Sales	15%	3%
Debt Burden	Debt free	$37,290,000 short term debt
Listing of Common Stock	N.Y. Stock Exch.	Not listed

The SUGAR-MILLING merger was the brainchild of William White, Jr., who, together with his family and friends, held over 36% of the MILLING stock. White's interest in SUGAR

[2] The 1967 fiscal year figures are the latest in the record. The 1965 and 1966 fiscal year figures show substantially the same proportions (DCM 5 pp. 12-15, 45, 51; P 37).

[3] Of this, 40¢ was derived from disposition of properties and not ordinary operations. None of SUGAR's earnings reflect gains from sale of properties.

common was one share and a remainder interest in the income from family trusts holding approximately one-third of 1% of the outstanding SUGAR common (*infra*, p. 3A) (Tr. 549-563, 627-637, 1112-1168; DCM 5 pp. 2, 27-28; P 22; P 23; P 40). At the time of approval of the merger agreements in April 1967, by the MILLING and SUGAR Boards of Directors, White was Chairman of the MILLING Board. The SUGAR Board consisted, except for one salaried employee, entirely of MILLING designees, including White, his personal attorney Mark Maged (also a member of the MILLING Board), Earl Cross, a MILLING director (formerly President of MILLING and now President of SUGAR) and Mr. A. Z. Kouri (also a member of a MILLING Board advisory committee) (Tr. 1797-1801; DCM 5 pp. 3-4).

The effect of the merger, agreed to on behalf of SUGAR by the MILLING designated Board of Directors, is as follows:

	SUGAR Public Common Stockholder	MILLING Common Stockholder
Earnings per Share	Down 12%	Up 105%
Dividends per Share	Up 24%	Up 50%
Market Price per Share (at High)	Up 66⅔%	Up 147%
Market Price per Share (at Low)	Up 28%	Up 70%
Cash Flow per Share	Down 16%	Up 112%

Before MILLING had acquired control of SUGAR by its April 4, 1966 tender offer made with a view to merger (*infra*, p. 29A), the respective market prices of the common stock had been 41 for SUGAR and 40 for MILLING. The terms of the proposed merger were publicly announced in Feb-

ruary 1967. Within that month the MILLING market price rose to more than 155% of SUGAR's, and by May 1967, following formal Board approval, this figure rose to 185% (DGW 6 corrected at R. 1453a). This market price disparity markedly decreased with commencement of trial, but following release of the District Court's Opinion and denial of plaintiff's application for a restraining order, the market price of MILLING stock immediately rose again to approximately 175% of that of SUGAR common. The present ratio is 215%.

In April 1966 White had caused MILLING to make a public tender offer for some SUGAR common stock and sufficient SUGAR preferred stock to give MILLING control in the voting for directors of SUGAR, with a view to merger of the two companies (*infra*, pp. 3A to 4A, 28A to 29A). MILLING required a short term bank loan of $37,290,000 (approximately $14,000,000 more than its net worth) to finance this tender, and the actual loan instruments conditioned consummation of the loan upon MILLING obtaining through the tender offer sufficient SUGAR stock to give it control over the election of SUGAR's directors (P 16). The bank's testimony confirmed that they looked primarily to SUGAR's assets to repay the loan after merger. The tender offer was successful, and on June 1, 1966 a new SUGAR board was elected, of which a majority were MILLING designees (Tr. 1010-1016, 1031-1032, 1216-1223; DCM 5 pp. 3-4, 27-31; P 3 p. 4).

In September 1966 White arranged to employ Standard Research Consultants, Inc. ("SRC") to recommend merger plans for SUGAR and MILLING. White's written instruction was that MILLING was to be either the surviving or the dominant company (P 1).

The first two plans drafted by SRC (P 5; P 6) were much more favorable to SUGAR's public common stockholders

than the ultimate merger plan, but were discarded at a meeting among SRC, White and his attorney, Mark Maged (Tr. 253). At this time, White and Maged, were already directors of both MILLING *and* SUGAR. These discarded proposals were not disclosed to any other member of SUGAR's Board (Tr. 1876-1879). Shortly after this meeting, SRC presented a merger plan which, by remarkable coincidence, was identical to the terms of a plan discussed earlier by White with SUGAR's then President, John Bunker, and which was considerably more favorable to MILLING than the discarded plans both financially and in avoiding dilution of the White group's control (Tr. 185-405, 796-803, 1542-1551, 1734-1740, 1860-1879; DCM 1; P 1; P 5; P 6; P 8; P 63).

This plan called for MILLING shareholders to receive one share of common stock of the merged company for each share of MILLING, and for SUGAR public common shareholders to receive, for each of their shares, 3/10 of a share of common of the merged company and one share of a new non-convertible preferred paying $1.75 per annum.

The merger plan was then given to Dillon Read, SUGAR's financial adviser, who, after intensive analysis and review, concluded that it was not fair or equitable to SUGAR's public common stockholders because it failed to provide them sufficient equity participation, earnings growth, and other values in the merged company relative to what SUGAR was contributing to the merger (Tr. 665-668, 677-691).

SUGAR's directors permitted Dillon Read to express its opinion and make suggestions but specifically prohibited Dillon Read from negotiating (Tr. 1742, 1745, 1879-1880). At a meeting between Dillon Read and SRC, Dillon Read

stated its reasons for believing the plan unfair to SUGAR's public common stockholders (Tr. 691-695, 731-736, 275-283, 287-306, 360-365). At a later series of meetings in October 1966 at which White and Dillon Read were in attendance, Dillon Read sought to suggest more common stock for SUGAR's public common stockholders and a convertible rather than a non-convertible preferred, but White, in the conflicting position of MILLING and SUGAR director, reacted very unfavorably, and did not even permit the discussions to reach the threshold of negotiations (Tr. 695-703, 707-710, 1745-1755). Finally, White, without consulting the SUGAR Board, told Dillon Read on October 24, 1966 that if Dillon Read did not think the SRC plan fair, another investment banker would have to be found to replace them as SUGAR's financial adviser, and the talks with Dillon Read were broken off within the week (Tr. 709-710).

The replacement of Dillon Read was further confirmed at a meeting of November 3, 1966 among White, Maged and SRC. SRC's oral testimony at trial confirms the facts as set forth in a memorandum of that meeting prepared by the President of SRC (Tr. 366-368). The memorandum, introduced into evidence at trial and never challenged by defendants, revealed the following (P 12):

> "Messrs. White and Maged came in today to discuss our proposed plan of merger. In the conversation it was stated that Dillon Read could not approve the plan we had proposed. Under the circumstances, it is proposed to take Dillon Read off this assignment and possibly retain another bank. Even if this is done, however, Mr. Maged feels that our present plan will have to be changed in some detail; otherwise he will have to reveal to the SEC that the plan being pro-

posed was turned down by Dillon Read. I, personally, don't follow this reasoning. In any event, in the discussions there were raised some thoughts as to whether the plan could be reversed so that Great Western Sugar would acquire Colorado Milling. However, on this plan and under the facts as given to us the earnings of GWS would be diluted down from $4.57 to $4.28 per share and those of Colorado Milling would be increased from $3.25 to $6.42.

"There was also another plan proposed. In the final analysis, however, we told Mr. White that we just literally could not see how GWS could initiate a plan in which their earnings would be diluted. Apparently this opinion coincided with the opinion of Mr. Maged.

"Thereafter, we got to discussing the possibility of changing our present plan. One thought was that the common stock be given a convertible, preferred stock and possibly .33 shares of common stock instead of the present proposal of a standard preferred stock and .3 shares of common. Mr. Maged seemed to think this was not a sufficient change over our preceding plan. We asked what would be a sufficient change, and he, himself, is not too sure." (Emphasis supplied)

Thereafter the SRC plan was changed, in a manner which SRC conceded was not significant (Tr. 334-350), by according SUGAR common stockholders 1/3 of a share, instead of 3/10, of the new common and increasing the dividend on the non-convertible preferred from $1.75 to $1.80.

At the next SUGAR Board meeting Mr. Ben-Fleming Sessel (one of the other MILLING designees on the SUGAR Board) who, to that point, had discussed the merger pro-

posal only with Messrs. White and Maged, suggested that Dillon Read should be replaced (Tr. 1033-1052, 1762-1763, 1840-1844). Mr. Sessel conceded that he had met with White and Maged in October 1966 to discuss the merger but he claimed he could remember very little of the meeting except that he had thought the plan was fair to SUGAR. He sought to justify his absence of any meaningful recollection by testifying "I wasn't asked to think anything else" (Tr. 1036).

At this SUGAR Board meeting, one of the directors who was not a MILLING designee suggested that Dillon Read be permitted to do some negotiating rather than that a new SUGAR financial adviser be designated (Tr. 1843). This suggestion was not adopted by the MILLING-controlled SUGAR Board, which instead proceeded to do what White had earlier threatened. It approved Mr. Sessel's suggestion to replace Dillon Read, and hired Kidder Peabody—not to negotiate but to evaluate the SRC plan (Tr. 1617, 2226-2227).

Kidder Peabody admittedly did not evaluate fairness on the basis of whether there was a fair and proportionate sharing of the merged company between MILLING stockholders and SUGAR public common stockholders relative to the respective contributions of each (Tr. 1617-1627, 2221-2224; DCM 4). It concluded that the SRC plan (with the minor modification of increasing the preferred dividend from $1.80 to $1.88) was fair to SUGAR's public common stockholders simply on the grounds that for them there was an anticipated dividend increase and anticipated market premium, though the increases for MILLING's shareholders were considerably greater, and though there was an earnings and cash flow decrease for SUGAR's public common

stockholders in contrast to a doubling of earnings per share and cash flow per share for MILLING's stockholders (Tr. 1624-1626).

Following Kidder's report that they found the plan fair, it was adopted in principle, though not formally approved, at a January 20, 1967 meeting of the SUGAR Board, without any further consultation with Dillon Read (Tr. 706, 1898-1900, 1564-1565).

About one month later three of the remaining four members of the SUGAR Board who were not MILLING designees precipitously resigned without notice. One of these had been the President of SUGAR, and another its Chairman of the Board (Tr. 1797-1801; DCM 5 pp. 3-4). These vacancies were filled by additional MILLING designees, who now comprised all members but one of the SUGAR Board. These included White, his attorney Maged, Mr. Cross (MILLING's President), Mr. Sessel (who had been the officer at Irving Trust Company in charge of approving MILLING's tender offer loan, and personal loans made by White to finance his acquisition of control of MILLING) (Tr. 1010-1052), and also a Mr. Von Kaenel. Mr. Von Kaenel, after he became a SUGAR director in June 1966, threatened to do things which "would have a very bad effect on SUGAR and its operations," in response to the comment by SUGAR's President that SUGAR ought to be in no hurry to move ahead with merger. For this Mr. Von Kaenel subsequently apologized (Tr. 1868-1874, 1247-1262).

In February 1967, about a month after the SUGAR Board had approved the merger in principle, Dillion Read was contacted by Mr. Sessel. The admitted purpose of contacting Dillon Read at this time was not to obtain their opinion whatever it might be, but to obtain their opinion

only if it were a favorable one, or to obtain a letter from Dillon Read saying that it was not Dillon Read's policy to review the opinions of other banking firms (*i.e.* Kidder Peabody). Dillon Read refused to send such a letter, stating that was not their policy. Dillon Read, after a review of the slightly revised plan, told Mr. Sessel that in its opinion the modified plan was still not fair since it did not give sufficient equity interest to SUGAR public stockholders in the merged company (Dillon Read reaffirmed this opinion at trial, see Tr. 742). Dillon Read advised Mr. Sessel that it did not believe that if it spent a lot more time on studying the plan, that would change its opinion that the plan was unfair. In these circumstances, Mr. Sessel preferred not to have Dillon Read make any further study of the plan[4] (Tr. 711-731, 771-775, 944-995).

This was not the last attempt to change Dillon Read's opinion. After commencement of trial but before Mr. Wadsworth (Dillon Read's Executive Vice President) testified, he was contacted by Mr. Gordon, Chairman of the Board of Kidder, at the request of Mr. White. Mr. Gordon sought to determine, without success, whether Dillon Read might meet with Kidder Peabody to see whether they couldn't alter their view as to the unfairness of the merger plan (Tr. 968-972, 1655-1658). Dillon Read

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[4] While the facts here recited are taken from Dillon Read's uncontroverted oral testimony, we submit that the Court below erred in excluding (Tr. 960, 1328) an even fuller written memorandum (P 32 printed at R. 1528a-1533a) of these February events prepared by Mr. Wadsworth, the Executive Vice President of Dillon Read, very shortly after they occurred and offered in evidence by plaintiff as a past recollection recorded. See 3 *Wigmore on Evidence* 64 et seq. (1940). (See also Tr. 720-723, 951-952 and 956-960 for the foundation laid for the admission of this Wadsworth memorandum.)

thereafter testified at the trial that the merger plan was unfair to plaintiff's class (Tr. 665-668, 677-691, 742).

The disproportionate effects of the merger as outlined above on earnings, dividends, cash flow and the like were evident from the application of the merger terms to the fiscal 1967 statements of the two companies; and even the disproportionate effect of these merger terms on market price, as evidenced by the market's reaction between public announcement of the terms in January 1967 and formal Board approval on April 12, 1967, was available and of course known by the MILLING-controlled SUGAR Board prior to voting that formal approval.

Reasons for Granting the Writ

The decision below has the effect of barring relief to public stockholders of a dominated corporation no matter how culpable the conduct of its director-fiduciaries (having personal interests conflicting with those of the public stockholders), in the formulation and effectuation of a merger with the dominant corporation, if in inquiry after the fact the directors can persuade a court that the plan is arguably fair. We submit that the culpable conduct should itself be a bar to the merger since public stockholders should not be required to ascertain retrospectively whether the outcome would have been more favorable had their directors met their fiduciary obligations.

This Court has consistently held that in dealings between a director and his corporation the transaction must carry the "earmarks of an arm's length bargain,"[5] and

[5] *Pepper* v. *Litton*, 308 U.S. 295, 306, 60 S.Ct. 238, 84 L.Ed. 281 (1939).

must be free "from motives of selfishness."[6] In this era of conglomerate mergers, tenders and take-overs, the federal securities laws can surely demand no less without giving license to the very practices those laws were designed to proscribe.

Moreover where, as here, the uncontroverted facts as to the culpable conduct were not fully disclosed in the proxy statement soliciting the necessary votes for the merger, relief must surely be provided to the public stockholders regardless of the post-fact judicial inquiry into fairness.

Finally, the lower court's conclusion of "fairness" was predicated on a weighing of pros and cons of the type that would apply to a case attacking only the business judgment of a director having no conflict. The long established law reflected in this Court's decisions is that in a situation involving conflict on the part of controlling directors "the entire fairness"[7] of the transaction must be shown and the transaction will be set aside on even "slight grounds."[8] This is the import of Judge Cardozo's classic statement that "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties."[9]

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[6] *Twin-Lick Oil Company* v. *Marbury*, 91 U.S. 587, 590, 23 L.Ed. 328 (1876).

[7] *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 599, 41 S.Ct. 209, 65 L.Ed. 425 (1921).

[8] *Twin-Lick Oil Company* v. *Marbury, supra*, 91 U.S. 587, 588.

[9] *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545 (1928).

I.

The Decision Below Denies Relief for Culpable Conduct of Director-Fiduciaries Violative of Section 10(b) of the Securities Exchange Act of 1934.

The bulk of the Court of Appeals' opinion was devoted to an analysis of arguments with respect to the fairness and unfairness of the merger, from which it concluded that though "difficult to pass on," (*infra*, p. 14A) the terms of the merger were on balance fair. Plaintiff's contentions that defendants' conduct breached their fiduciary obligations and that this violates Section 10(b) is disposed of in that opinion in a single sentence without discussion, as "without merit" (*infra*, p. 15A). Inasmuch as the facts constituting the conduct were undisputed, the Court of Appeals' determination that this contention was without merit must be deemed to be a determination of law, viz., that such conduct of fiduciaries has no legal significance.

That determination below merits the granting of this application for certiorari in order that it be made clear that directors of a public corporation may not, under the federal securities laws, engage with impunity in the conduct here established by the uncontroverted facts.

There is no question but that an exchange of securities incident to a merger is such a connection with the purchase or sale of a security as to bring it within the purview of Rule 10b-5. *SEC* v. *National Securities, Inc.*, No. 41, Oct. T. 1968, decided by this Court on Jan. 24, 1969; *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627 (2d Cir. 1967), *cert. den.*; *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262 (7th Cir.

1967), *cert. den.; Voege* v. *American Sumatra Tobacco Corp.*, 241 F.Supp. 369 (D.Del. 1965).

The term "fraud" as used in the securities laws is not limited to common-law fraud but encompasses the broad range of fiduciary breaches. *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, at 193-195 (1963).

Petitioner submits that breaches of fiduciary duty constitute within the meaning of Rule 10b-5 a "device, scheme, or artifice to defraud" or the engagement in an "act, practice, or course of business which operates or would operate as a fraud or deceit" under the broad view of that Rule taken in *Vine* v. *Beneficial Finance Co., supra; Dasho* v. *Susquehanna Corp., supra; Voege* v. *American Sumatra Tobacco Corp.,.supra; Entel* v. *Allen*, 270 F.Supp. 60 (S.D. N.Y. 1967); *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968).

In a variety of cases courts have held that a director's breach of fiduciary duties constitutes constructive fraud. For example, the Court of Appeals for the Sixth Circuit in *Seagrave Corp.* v. *Mount*, 212 F.2d 389 (1954), enjoined at the suit of minority stockholders a proposed corporate acquisition on the ground that the directors in approving the plan were seeking a personal profit. The Court there stated on facts less grievous than those before this Court:

> "Constructive fraud refers to acts which may have been done in good faith, with no purpose to harm the corporation, but which are done by one who has placed himself in a position of conflict between a fiduciary obligation and his own private interests." (p. 397)

The legal standards to be applied in determining whether defendants' conduct constitutes a breach of fiduciary duty

are made clear by decisions of this Court. *Twin-Lick Oil Company* v. *Marbury,* 91 U.S. 587, 23 L.Ed. 328 (1876); *Geddes* v. *Anaconda Copper Mining Co.,* 254 U.S. 590, 41 S.Ct. 209, 65 L.Ed. 425 (1921), and *Pepper* v. *Litton,* 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939). (See also the landmark decision of Cardozo, J. in *Meinhard* v. *Salmon,* 249 N.Y. 458, 164 N.E. 545, 62 A.L.R. 1 (1928).)

It is plain that these fiduciary standards were not met but were violated by the following undisputed conduct of the defendants (see *supra,* pp. 5-14):

1. The defendants through their April 1966 tender offer sought out their position of conflict, did so with monies borrowed by MILLING with the expectation that the loan would be repaid out of SUGAR assets, and did so for the very purpose of dominating the development of the merger.

2. MILLING immediately in June 1966 took control of SUGAR's Board, instead of insulating the SUGAR Board from MILLING and enabling it to negotiate independently.

3. White, who should have stepped aside or at the very least taken some prophylactic steps to blunt the impact upon SUGAR of his dominant and conflicting position, became instead the principal protagonist of the merger terms. His designees on the SUGAR Board not only used but abused their power of control over the SUGAR Board, as evidenced by threats made by one of those designees (Von Kaenel) to injure SUGAR unless the merger were consummated as rapidly as White wished.

4. White, though a director of SUGAR as well as MILLING, gave written instructions to SRC that MILLING be the sur-

viving or dominant company. No SUGAR director ever questioned these instructions though SUGAR was many times the size of MILLING in assets, earnings and every other respect (see *supra*, p. 6).

5. The two initial plans prepared by SRC and discarded at the meeting with White and his attorney Maged (members of both SUGAR's and MILLING's Boards), were more favorable to SUGAR's public common stockholders than the ultimate merger plan, but were never disclosed to any other members of the SUGAR Board.

6. SRC could not see how SUGAR "could initiate a plan in which their earnings would be diluted," and so informed White and Maged. Yet the White-dominated SUGAR Board *accepted* just such plan (see *supra*, p. 11).

7. Despite Dillon Read's finding that the SRC plan was unfair to SUGAR's public common stockholders, White, though the dominant influence on the SUGAR Board through his control of MILLING, adamantly resisted improvement in the terms for SUGAR.

8. On October 24, 1966, White threatened Dillon Read with replacement if they did not find the SRC plan fair, and on November 3, 1966 White told SRC that it was proposed to take Dillon Read off this assignment, which was done (see *supra*, p. 11).

9. Had White and Maged sought fair procedures they would have made certain that SUGAR was represented by a team both authorized to bargain and insulated from their domination. They not only failed to do this, but made certain that no real bargaining or negotiation ever took

place. Thus, instead of minimizing their conflict role, they maximized it.

10. Even when Kidder was engaged, they were not called to negotiate but merely to "evaluate." Nor did Kidder ever seek authority to negotiate.

11. In evaluating fairness to SUGAR, Kidder conceded that it relied solely on the merger's effects on SUGAR instead of comparing its effects on both MILLING and SUGAR. Its standard was unilateral, rather than bilateral as it should have been, and thus the SUGAR Board, in purporting to rely upon Kidder, was adopting a conclusion of fairness grounded upon an improper standard, and indeed did not even inquire as to what standard Kidder employed.

12. The desire for a "fresh look" which was defendants' purported reason for Kidder's retention was in MILLING's interest, not SUGAR's. SUGAR was already well represented by Dillon Read whose objective was to get a fair deal for its client SUGAR. Had the earmarks of an arm's length bargain been defendants' objective, they would have insisted that Dillon Read negotiate for SUGAR; and if any substitutions were in order, a new financial house would have been substituted for SRC (White's appointee) to take a fresh look at Dillon Read's objections.

13. Following January 1967, when the stock market reacted to the announcement of the merger terms by a grossly disparate increase in the price of MILLING stock in relation to SUGAR common stock, and continued to reflect the disparity in the months ensuing, the MILLING-domi-

nated SUGAR Board gave not even a thought to adjusting the terms. Instead the terms were adopted in the final agreement approved by the SUGAR directors on April 12, 1967.

14. Indeed, the final merger agreement adopted by the SUGAR directors embodied a provision, nowhere present in the written reports of SRC or Kidder, for a 15% reduction of the sinking fund redemption price of the $1.88 preferred going to petitioner's class from $28.80 per share to an average of slightly more than $24.50 per share.

15. The SUGAR President and director (Mr. Bunker), who resigned and sold all of his SUGAR common stock prior to formal approval of the merger by the SUGAR Board, testified (Tr. 1867) that had he not resigned he would have had checked such matters as the failure of MILLING's earnings to reflect pension liability expense aggregating $4 million by 1967 (while SUGAR's pension liability was fully funded on its books), and MILLING's inventory figures in the light of the statement by White's assistant (Walter) that by the manner in which MILLING valued its inventory it could change its profits by $2 million (Tr. 779-780), an amount greater than MILLING's published 1967 earnings. The record is devoid of any proof that anyone did, in fact, check these points on behalf of SUGAR even though they had been raised by Dillon Read, and SRC conceded that it ignored them in formulating the merger terms (Tr. 275-283, 287-306, 310-312, 731-736, 759-780, 847-851).

16. The uncontroverted testimony at trial of Dillon Read's officers relating their conversations in February 1967 with Sessel and Maged (MILLING's SUGAR Board

designees) reveals that the purpose of recontacting Dillon Read was not to obtain their opinion, unless it were one that would help effect the merger already determined upon.

17. White was less than candid with the SUGAR Board in failing fully and frankly to inform them of the substantial amount of his personal loans against his MILLING stock, or of his contemplated secondary offering to repay those loans. He did not reveal to any SUGAR director, other than his attorney Maged, the vital personal importance to him, therefore, of the merger terms, which would affect materially the price of his intended secondary offering of MILLING stock (Tr. 1125, 1155-1158).

II.

The Decision Below Denies Relief for Inadequate Disclosure in the Merger Proxy Statement Which Violates Section 10(b) of the Securities Exchange Act of 1934.

The Court below, without any discussion whatever, also found to be without merit (see *infra,* p. 15A) petitioner's contention that defendants' failure to disclose material information in the proxy statement used to solicit votes for the merger constituted a violation of Section 10(b). Again, since the facts omitted from the proxy statement are not in dispute, this must be deemed a finding that such omissions are without legal significance under Section 10(b).

In *SEC* v. *National Securities Inc.,* No. 41, Oct. T. 1968, decided Jan. 27, 1969, this Court determined that a merger proxy statement which contains material misrepresentations or omissions constitutes a violation of Section 10(b). This Court on April 21, 1969 granted a writ of certiorari

to the U.S. Court of Appeals for the Seventh Circuit in the case of *Mills and Susman* v. *The Electric Autolite Company, et al.*, 403 F.2d 429 (1968), in a case where the question presented was whether minority stockholders were to be denied relief for material misrepresentations in a merger proxy statement, violative of Section 14(a) of the 1934 Act, if the Court were satisfied that the merger terms are fair by common law standards.

We respectfully submit that the same question should be determined by this Court under Section 10(b), a question that is presented by the instant application for certiorari.

In the *Mills* case, *supra,* the defect in the proxy statement was that it did not sufficiently emphasize the fact that the Board of the company of which plaintiff was a stockholder, and which had endorsed the merger, was controlled by the adverse party in the merger. Though those facts concerning conflicts of interest appeared in the proxy statement, the Seventh Circuit found the proxy statement misleading as a matter of law because it failed to appropriately juxtapose the facts of conflict with the Board's endorsement and recommendation. The Third Circuit, in the instant case, is in conflict with the Seventh Circuit since it failed to find misleading a proxy statement which, in addition to the defect present in the *Mills* case, also entirely omits any reference to the chain of facts which constitute a course of conduct by the SUGAR directors in breach of their fiduciary duties owed SUGAR's public stockholders.

Thus:

1. While the 100-page printed proxy (DCM 5), if closely studied, revealed the fact that the SUGAR Board consisted of MILLING designees, it fails—in the section setting forth

the recommendation of the SUGAR Board that the public stockholders of SUGAR should approve the merger (DCM 5 p. 5)—to juxtapose or include any reference to the fact that the Board making that recommendation consisted wholly of designees of MILLING except for one member—who was a salaried SUGAR employee.

2. Moreover, while this recommendation stated (DCM 5 p. 5) that it was made "after thorough consideration and study," the undisputed evidence shows that the consideration and study by SUGAR's Board was far from thorough. Mr. Sessel, for example, testified (Tr. 1033) that he never even attended a discussion of SUGAR directors as to whether, apart from the question of *terms* of merger, a merger at all between MILLING and SUGAR was desirable from SUGAR's point of view. The lack of thoroughness in the consideration given by the SUGAR Board is reflected by many other of the factors discussed at pages 8 to 14 above, none of which was disclosed in the proxy statement.

3. The same recommendation section states that one of the benefits which would result from the merger is that: "the combined enterprise will have the benefit of increased total resources." This was not true for SUGAR, whose pre-merger net worth was $94 million, as compared to the post-merger net worth of the merged company of $77 million, a reduction which was the direct result of the fact that the merged company would be loaded down with debt incurred by MILLING to acquire control of SUGAR (R. 1366a).

4. Again, the recommendation section alleged as another benefit that "the combined enterprise will have greater depth of management." SUGAR's President, who

was also a member of the SUGAR Board, testified that this was not his opinion (Tr. 1767-1768). Defendants' own expert at trial stated that any attempt to change the management of SUGAR could be "disastrous" (Tr. 2031). At the directors' level, the same White group was already in control of SUGAR and MILLING. And finally, since the consummation of the merger SUGAR and MILLING have been operating as separate entities.

5. The proxy statement omits entirely any reference to each and every one of the highly material and uncontroverted facts constituting the culpable conduct set forth above at pages 8 to 14.

In *J. I. Case* v. *Borak*, 377 U.S. 426 (1964) this Court decided that the procurance by management of authorization for corporate action by means of inadequate disclosure in a proxy solicitation is a violation of the securities laws. Though a different section of the 1934 Act was there involved, under *SEC* v. *National Securities, Inc., supra*, the same would be true where the violation is of Section 10(b). To hold otherwise, as is the effect of the ruling of the court below, would make the fraud resulting from a proxy violation of Section 10(b) of no consequence unless the Court concluded that the resultant merger was substantively unfair.

In *SEC* v. *Capital Gains Bureau*, 375 U.S. 180, 186, 195, 201 (1963), this Court stated: "Congress intended a broad remedial construction of the Act which would encompass non-disclosure of material facts" and not merely the technical requirement of "intent to injure and actual injury", and that the requirement of full disclosure is "essential to maintain public confidence in the securities industry and to preserve the economic health of the country."

In *Eagle* v. *Horvath,* 241 F.Supp. 341, 344 (S.D.N.Y. 1961), the Court stated that insiders "cannot accomplish by deception what they might have accomplished honestly and then be heard to say that the deception was not the cause."

III.

It Is Improper Under Section 10(b) of the Securities Exchange Act of 1934 to Use the Legal Standards of the Business Judgment Rule in Appraising the Merger Terms, as Did the Court Below.

In its review of "fairness" the Court below improperly applied legal standards which would be applicable in a business judgment case. Section 10(b) requires, at the very least, application of the more stringent standards governing controlling fiduciaries in a self dealing transaction under which the merger must be set aside if it is in the slightest degree unfair or fails to carry the ear-marks of an arm's length bargain. *Twin-Lick Oil Company* v. *Marbury,* 91 U.S. 587, 23 L.Ed. 328 (1876); *Geddes* v. *Anaconda Copper Mining Co.,* 254 U.S. 590, 41 S.Ct. 209, 65 L.Ed. 425 (1921), and *Pepper* v. *Litton,* 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939). (See also the landmark decision of Cardozo, J. in *Meinhard* v. *Salmon,* 249 N.Y. 458, 164 N.E. 545, 62 A.L.R. 1 (1928).)

Under the rule as stated by Judge Learned Hand, the appropriate test would require defendants to prove that the dominant corporation (MILLING) received in the merger not more than the least which it would have accepted in arm's-length negotiation. *Ewen* v. *Peoria & E.Ry. Co.,* 78 F.Supp. 312, 317 (S.D.N.Y. 1948), *cert. den. sub nom.*

Income Bondholders of Peoria & E.R. Co. v. *New York Central Railroad*, 336 U.S. 919 (1949).

The lower court concluded that the issue of fairness "is most difficult to pass on" and that a large basis for "justification of the merger" is "the caliber of management and [MILLING's] corporate growth potential" (*infra*, p. 14A). This conclusion of itself demonstrates that the legal standards required by the cases cited above have not been met. In the first place, if the fairness issue is "most difficult to pass on," we submit that there exists at least the "slight grounds" sufficient to invalidate the transaction in a conflict of interest case. Moreover, the "caliber of management" argument, *i.e.*, White's "dominant influence in MILLING and the resultant growth orientation of the corporation" (*infra*, p. 10A), which was relied upon by the court below to offset the 10-15% dilution in the per share earnings of plaintiff's class and the doubling of those of MILLING's shareholders as a result of the merger terms, must fall as a matter of law. This is because whatever the factual weight to be accorded intangible factors of growth "potential," or "orientation," and management "caliber," these factors belonged equally to both companies in the merger as a matter of law. Since early June 1966 and continuously up to the time of Board merger approval in April 1967 and through the time of consummation in January 1968, the White group constituted the controlling directors of both SUGAR and MILLING. SUGAR, therefore, possessed equally with MILLING whatever benefits of management "caliber" and growth "potential" be accorded the White group; and the White group owed the same fiduciary obligation to SUGAR as to MILLING for management and growth. Significantly, "potential" growth aside, the

only *actual* growth up to the time the merger terms were formulated was MILLING's pursuit of a merger with SUGAR, and the only growth thereafter were acquisitions financed by SUGAR's funds (DCM 5 pp. 25-26). Indeed, if value is to be attributed to the White management's growth "potential," it is to SUGAR's side of the equation, and not MILLING's, to which this value should be added. It is SUGAR, and not MILLING, which had the financial wherewithal to finance such growth (DCM 5 p. 15, also see *supra*, p. 6).

MILLING and the White group, as controlling stockholders of SUGAR, may not appropriate for themselves alone either tangible or intangible values adhering to all shares. See, for instance, *Perlman* v. *Feldmann*, 219 F.2d 173 (2d Cir. 1955); *Zahn* v. *Transamerica Corp.*, 162 F.2d 36 (3rd Cir. 1947); *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808 (D. Del. 1951) and 235 F.2d 369 (3rd Cir. 1956).

It is not necessary for a finding that this merger plan violates Rule 10b-5 that this Court reappraise the fairness arguments by the test of the business judgment rule. The most that need be determined in this conflict of interest situation is that there exist "slight grounds" for finding that the merger terms do not bear the "ear-marks of an arm's-length bargain." It cannot be said that such slight grounds do not exist in view of the following:

(a) The lacuna in the reasoning by which the lower court justified the merger terms on grounds of the White group's growth "potential" while ignoring that this belonged as much to SUGAR as to MILLING.

(b) The lower court's assumption that the earnings trend over a five-year period portended greater earnings prospects for MILLING than for SUGAR (*infra*, p. 10A)—in face

of the fact that the Kidder report (which the lower court itself stated must be the principal justification for the merger, *infra,* p. 8A) projected greater earnings growth for SUGAR than for MILLING (DCM 4, Exh. III, Exh. IV).

(c) The prestigious Dillon Read firm rendered the opinion that the plan was unfair to plaintiff's class and refused to withdraw that opinion despite pressure to do so from the defendants.

(d) The fact that in an arm's-length negotiation SUGAR would have been dominant because it was the larger and stronger company, while MILLING would have been under the pressure of its $37,290,000 short-term debt—facing a possible loss of 30% of its net worth if the merger did not eventuate and it were forced to liquidate its SUGAR holdings. In these circumstances would an arm's-length negotiator for SUGAR have agreed to a per share decrease in earnings and cash flow while those of MILLING doubled, or to give MILLING the lion's share of market price and dividend increments, or to give up most of its equity growth position for a non-convertible redeemable preferred?

(e) When MILLING acquired control of SUGAR through tender it was MILLING which occupied the preferred stockholders' static position *vis-a-vis* SUGAR's assets and earnings. The merger permitted MILLING to retain control and at the same time converted its static preferred position into common stock while converting most of the SUGAR common stockholders' position into static preferred stock of the merged company.

(f) The merger terms had at least that degree of unfairness as to lead the President of SRC to believe that SUGAR

could not "initiate" the plan because of the earnings dilution (*supra,* pp. 10 to 11). Defendants have never even sought to explain or justify their *acceptance* as SUGAR directors of a plan which SRC believed SUGAR could not *initiate.*

To the foregoing list of "slight grounds" should be added the other matters discussed in I and II above.

IV.

The Merger Transaction Also Violates New Jersey State Law.

The matters referred to above as violative of Rule 10b-5 also violate New Jersey state law. *Brundage* v. *New Jersey Zinc,* 48 N.J. 450, 226 A.2d 585 (1967); *Outwater* v. *Public Service Corp.,* 103 N.J.Eq. 461, 143 Atl. 729 (1928), *aff'd* 104 N.J.Eq. 490; *Colgate* v. *U.S. Leather Co.,* 73 N.J.Eq. 72, 67 Atl. 657 (1907), rev'd on other grounds 75 N.J.Eq. 229, 72 Atl. 126; *Copeland* v. *United Shoe Machinery,* 84 N.J.Eq. 276, 94 Atl. 404 (1915). By reason of diversity of citizenship and the doctrine of pendent jurisdiction (*United Mine Workers* v. *Gibbs,* 383 U.S. 715 (1966); *Hurn* v. *Oursler,* 289 U.S. 238 (1933)), the question of this violation should be reviewed by this Court.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 5, 1969

APPENDIX A.

Opinion of the Court of Appeals, Amendments Thereto and Judgment

[1]

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 17080

JANE LEVIN, ON BEHALF OF HERSELF AND ALL OTHERS SIMILARLY SITUATED,
Plaintiff-Appellant,

and

MATILDA BURGER, ET AL.,
Common Stockholders-Intervener-Plaintiffs,

and

SAMUEL MEHLMAN, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED,
Preferred Stockholder Intervener-Plaintiff,

v.

THE GREAT WESTERN SUGAR COMPANY, ET AL.,
Defendants.

APPEAL FROM JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Argued November 22, 1968

Before GANEY, FREEDMAN and SEITZ, *Circuit Judges.*

OPINION OF THE COURT

(Filed February 5, 1969)

SEITZ, *Circuit Judge.*

Plaintiff, Jane Levin, the holder of 1100 shares of the common stock of the Great Western Sugar Company

[2]

(Sugar), commenced this action in the district court to enjoin the merger of Sugar and the Colorado Milling and Elevator Company (Milling) into a subsidiary of Milling, the Great Western United Corporation (United). Sugar, Milling, and United and the directors of Sugar and Milling were named as defendants[1] (defendants). Additional holders of 4100 shares of Sugar's common stock and one holder of preferred stock of Sugar, who filed his own complaint, intervened. After final hearing the district court rendered judgment for the defendants. This appeal is taken by plaintiff on behalf of herself and the other Sugar common stockholders only.

Plaintiff's complaint stated three claims. The first arose under § 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. § 78(j)(b)) and its implementing Rule 10b-5 (17 C. F. R. 240.10b-5) and provided the primary basis for federal jurisdiction. It alleged that the proposed merger by itself and in connection with certain activities on the part of defendants amounting to a scheme or conspiracy constituted an unlawful device, scheme, and artifice to defraud and were acts, practices, and courses of business which operated as a fraud and deceit upon plaintiff. The second claim alleged a New Jersey state law cause of action and rested on the pendent jurisdiction of the district court. It asserted common law fraud[2] and the unfairness of the terms of the merger as grounds for relief. The third claim again alleged the state law claim that the terms of the merger were unfair, but jurisdiction was based solely on diversity of citizenship and it was brought only against the corporate defendants (Sugar, Milling and United).

The heart of plaintiff's complaint is that the terms of the merger were unfair to the common stockholders of Sugar, giving rise to equitable relief under state law and

1 While certain other defendants were named in the first two counts of plaintiff's complaint in the district court, they are not involved in this decision, and, accordingly, no further reference will be made to them.

2 The common-law fraud claim was rejected by the district court and has not been renewed on appeal.

resulting in a fraud upon the Sugar common stockholders in violation of federal law. With this in mind, we turn to the pertinent background information. We note, preliminarily, that the dispute is not as to the basic facts found in the district court opinion but as to the inferences to be drawn therefrom.

Sugar was engaged in the production of Sugar and its by-products from sugar beets and was the largest sugar beet producer in the country, accounting for about 25% of the beet sugar marketed in this country and having a net worth of approximately $93,000,000 as of February 28, 1967. Milling was principally engaged in the manufacture and sale of wheat, flour, and mixes, and animal feeds. It also bought and sold grains, beans, seeds and fertilizers, and stored grains for the public in company-owned elevators. Milling's net worth was approximately $24,000,000 as of May 31, 1967.

The Sugar-Milling merger was the brainchild of William White, Jr. In December of 1964, White became a director of Milling, at the unanimous request of the directors of that company. In September of 1965, he became chairman of the Milling executive committee and, in April of 1966, chairman of the Board of Directors. In August of 1965, he began to purchase substantial quantities of Milling stock so that, by April of 1967, he held approximately 18% of that company's outstanding stock. The purchases were financed to a large extent by bank loans, which were secured in part by a pledge of the stock.

White first conceived of Milling making a public tender offer for Sugar stock in February of 1966, and, in April of that year, when the Sugar directors decided not to oppose it, Milling made the tender offer. It was financed by a loan, which was conditional on the successful completion of a merger between Sugar and Milling. The tender offer was aimed primarily at Sugar's preferred stock, since, by virtue of its unusual voting structure, each of the 150,000 preferred shares had one vote, while each of

the 1,700,000 shares of common had only 1/12 of a vote, thereby giving the aggregate preferred holders 47% of the voting power.

As a result of the purchases of the Sugar stock tendered it, Milling obtained virtual voting control of Sugar in electing directors. Concommitant with its new voting control, six of the eleven directorships were filled by Milling. A seventh director was William White's father, who had served on its board previously. He and the other four remained from the old administration.

White thereafter arranged for Milling to employ Standard Research Consultants, Inc. (SRC) to recommend one or more plans for a merger of Sugar and Milling. After two early draft plans involving the exchange of only common stock had been discarded, SRC finally came up with a plan which Milling was prepared to submit to Sugar and its financial advisers, Dillon, Read & Co. (Dillon Read). The plan called for Milling stockholders to receive one share of common of United for each of their Milling shares, and for Sugar common stockholders to receive for each of their shares 3/10 of a share of common and one share of non-convertible preferred paying $1.75 per annum of the merged company.

Dillon Read studied the plan and concluded that, although "it was in the ball park", and with some improvements might be acceptable, the plan was not fair or equitable to Sugar's common stockholders as it was then drawn, because it did not provide them with sufficient equity participation, earnings growth, and other values. Negotiations followed among White, the Sugar directors, and representatives from SRC and Dillon Read without success. Dillon Read suggested making more common stock available to Sugar common stockholders and using a convertible preferred. White proposed giving Sugar common stockholders an alternative of either all common or all preferred of United. Nothing came of these suggestions.

SRC then revised its suggested plan of merger as to Sugar common stockholders giving them 1/3 instead of 3/10

a share of United common for each of their shares and $1.80 per annum instead of $1.75 on the preferred, thereby increasing the Sugar common stockholders' equity participation in United by 10% and the dividend on their preferred by five cents. Apparently dissatisfied with the inability of Dillon Read to come to an agreement on the merger terms and in order to get a fresh look, Sugar suspended Dillon Read as its financial advisers and hired Kidder, Peabody & Company (Kidder Peabody) to appraise the revised plan of merger.

Kidder Peabody approved the plan with some modifications, one of which was a further increase in the preferred dividend rate from $1.80 to $1.87 per annum. After hearing a presentation of the Kidder Peabody report, the directors of Sugar on January 20, 1967, adopted the Kidder Peabody modifications and unanimously approved the merger in principle. Shortly thereafter the four independent, non-Milling directors, who had voted for the merger, resigned. Their places were taken by members of the White group.

The plan was again submitted to Dillon Read to see whether they would now approve the plan as modified. After a brief review, Dillon Read gave an oral opinion that it could not withdraw its objections or express an opinion as to the fairness of the plan without a new analysis, taking into account various developments which had taken place since its original study. Without authorizing Dillon Read to pursue the matter further, the Sugar board of directors approved the plan with the Kidder Peabody modifications and with a further increment in the United preferred dividend rate from $1.87 to $1.88 on April 12, 1967. The approval was made by a board consisting entirely of Milling designees. This civil action was commenced on June 27 of that year.

A stockholders meeting was called by Sugar for September 15, 1967 to vote on the merger. New Jersey law requires that the merger be approved by the votes of the

holders of ⅔ of all the capital stock of each of the merging corporations. 14 N. J. Stat. Ann. 12-3. Thus, Milling's 47% voting control of Sugar, which consisted mainly of preferred stock, was reduced for the purpose of approving the merger to only 22%. The vote resulted in an overwhelming approval of the merger, with some 92% of the shares being voted in favor of the merger plan. Even without the Milling votes, the merger was approved by independent stockholders owning more than ⅔ of all the shares. The Milling stockholders also approved the merger.

The plan as finally approved provided that both Sugar and Milling would merge into United, the subsidiary of Milling. Each share of Milling stock would be exchanged for a share of a United common. Each share of Sugar common would be exchanged for ⅓ of a share of United common and one share of United $1.88 non-convertible cumulative preferred, with a stated value of $24 and redeemable after five years at various prices ranging from $28.80 downward to $24. A sinking fund would be set up in order to pay for the redeemable shares. Each share of Sugar preferred would be exchanged for one $190 face amount subordinated debenture of United, with 6% interest, maturing on May 1, 1987, and subject to redemption.[3] The common and preferred shares of Sugar owned by Milling would be cancelled in consideration for United's assumption of the debts of Milling.

After the district court denied plaintiff relief below, she sought to restrain the merger pending the outcome of her appeal. The district court, as well as this court, denied the application for the restraining order, and, on January 16, 1968, the merger was consummated. It is not suggested that the merger may not be set aside if we find its terms to be unfair.

Before reaching the merits of plaintiff's objections to the merger, we must deal with defendant's jurisdictional

3 While a preferred stockholder attacked unsuccessfully the fairness of the plan as to his class in the district court, he did not appeal. The issue of fairness of the merger as to the Sugar preferred stockholders is, therefore, not before us.

[7]

objections. Defendants first contend that the district court did not have jurisdiction over the federal claim (for violation of Rule 10b-5 as implementing § 10(b) of the Securities Exchange Act of 1934), because plaintiff failed to state a claim thereunder. We think that the district court had jurisdiction over the subject matter of the 10b-5 claim. The contention of the failure to state a claim, however, is not a jurisdictional objection. Defendants' second contention is that there was an insufficient claim upon which to base the pendent jurisdiction of the district court over the state law claim in count two of the complaint. We believe that plaintiff asserted a sufficiently substantial claim under § 10(b) of the Securities Exchange Act and its implementing Rule 10b-5 to justify the district court's discretionary exercise of jurisdiction over the pendent state law claim.[4]

We now turn to plaintiff's contention that the terms of the merger were unfair to the Sugar common stockholders, keeping in mind that our duty is only to review the correctness of the material findings of the district court. Plaintiff alleged and the district court agreed that, despite the fact that after fair disclosure the merger plan was approved by independent Sugar stockholders owning more than ⅔ of all the shares, the burden of proof rested as a matter of New Jersey law on the defendants to show that the merger was fair. This was felt to follow from the rationale of Brundage v. New Jersey Zinc, 48 N. J. 450, 226 A.2d 585 (1967), because there were no arm's length negotiations. The majority of Sugar directors who negotiated and approved the merger were members of the White group and as such not disinterested. Since a review of New Jersey cases has convinced us that some of the statements of the law, as they may pertain to the circumstances of this case, are clouded, we will assume without deciding that the burden does rest on defendants to show that the merger is fair. Compare Brundage, *supra*, 226 A.2d at 598-599, with Eliasberg v.

4 See United Mine Workers v. Gibbs, 383 U. S. 715 (1966), and Knuth v. Erie-Crawford Dairy Coop. Ass'n., 395 F.2d 420, 426-427 (3rd Cir. 1968).

Standard Oil Co., 23 N. J. Super. 431, 92 A.2d 862 (1952), aff'd., 12 N. J. 467, 97 A.2d 437 (1953); and Outwater v. Public Service Corp., 103 N. J. Eq. 461, 464, 143 Atl. 729, 730 (1928), aff'd., 104 N. J. Eq. 490, 146 Atl. 916 (1929).

Defendant's principal justification for the terms of the merger must be the "independent evaluation" of the SRC plan by Kidder Peabody. It was on the basis of the Kidder Peabody report that the directors of Sugar unanimously approved the terms of the merger. In the report, Kidder Peabody concluded that the Sugar common stockholder:

> "1. Would find himself in a preferred equity position with respect to about 60% of market value of his new holdings;
>
> "2. Would receive securities with an indicated market value of $47.80 per share of equivalent [Sugar] common stock, or a value that is 21% higher than the present market for the common, and a value that also compares favorably with the price range of the common over the past ten years, with the exception of 1963;
>
> "3. Assuming that the dividend on [Milling] common is increased to $1.80, would receive a 20% increase in dividend income with 75% of such income in the form of a preferred and fixed payment;[5]
>
> "4. Would obtain an increase of ⅓ of a vote per share until such time as the cumulative preferred stock would be redeemed. Initially, the [Sugar] common shareholders would have about 53% of the votes of the surviving corporation;
>
> "5. Would also obtain an increase in book value from $24.95 to $34.70 per share;

5 The estimated total dividend package after merger for the Sugar common stockholders was $2.48, $1.88 on the preferred and $.60 on the common. The pre-merger figure was $2.00. Hence the percentages in number 3.

[9]

"6. On the other hand, would receive about a 10-15% dilution in per share earnings; and

"7. Would be receiving 'Section 306 Stock' and hence a favorable ruling from the IRS should be a condition for the exchange."

Plaintiff's principal objections are to numbers 2, 3, and 6 above: the findings of Kidder Peabody as to market value, dividend, and earnings per share. She does not take serious issue with the accuracy of the figures as representing the change in the position of Sugar's common stockholders as a result of the merger, but maintains that, when they are compared with the corresponding changes in the position of Milling's stockholders, the figures show a disproportionate benefit for Milling stockholders which makes the terms of the merger unfair to the Sugar common stockholders. We agree that plaintiff and the other Sugar common stockholders are entitled to a proportionate benefit in the merged corporation. We therefore turn to a close examination of plaintiff's claims as to disproportionality, mindful, nevertheless, that the burden of proof remains with defendants.

Earnings Per Share

Plaintiff maintains that whereas Sugar's common stockholders are suffering a 10-15% dilution in per share earnings (number 6 of the Kidder Peabody Report, quoted above) the Milling per share earnings more than double as a result of the merger. The disparity is even greater than indicated, plaintiff insists, because the figures do not reflect the differences in accounting procedures between the two companies.

A comparison of the earnings per share of the two companies since 1962 reveals the following: a steady increase in earnings for Milling over the past five years with the exception of 1967, but a slight decline in the earnings

per share of Sugar common since a peak in 1964.[6] The 1967 decline in Milling's earnings per share reflects the expenditures and loans incurred with respect to stock purchases pursuant to its tender offer for Sugar stock. The noticeable jump in the Milling earnings per share from 1965 to 1966 coincides with White's becoming a dominant influence in Milling and the resultant growth orientation of the corporation. It seems clear from the earnings' comparison chart that the prospects for growth in earnings for Milling in the future were excellent. Quite the opposite seemed true for Sugar, as the SRC Report pointed out:

> "The entire sugar industry, of which [Sugar] is a part, is affected by Quota Controls imposed by the Secretary of Agriculture. Such controls affect the importation of sugar and the amount of cane and beet sugar that may be grown in the United States. The fact that Sugar is subject to limitations imposed under the Quota System naturally affects the growth capacity of the company."

In view of the past performances of both companies, it was therefore fair to accord greater weight to Milling's earnings potential than to Sugar's and to reflect this in the disparate allocation of post-merger earnings.

In any event, the effect to be accorded the earnings per share disparity may be discounted to some extent by the fact that, as a result of the merger, the Sugar common shareholders have received a prior claim on earnings to the

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6:

	Milling		Sugar	
Earnings per share		*Pro Forma*		*Pro Forma*
Year	*Pre-Merger*	*After Merger*	*Pre-Merger*	*After Merger*
†1967	$2.94	6.03	4.42	3.89
*1966	3.52	—	4.57	—
*1965	2.42	—	4.63	—
*1964	2.18	—	4.96	—
*1963	1.70	—	3.30	—
*1962	1.66	—	4.03	—

† figures taken from the Sugar proxy statement.
* figures taken from the Kidder Peabody Report.

extent of their preferred holdings in United. Furthermore, the pre-merger earnings gap between the two corporations apparently reflected in part at least a reticence on the part of Sugar management to make capital improvements and a contrasting program on the part of Milling of continuous plant modernization and improvement.

We therefore conclude that, when all the above factors are taken into account, the earnings factor is fairly reflected in the merger terms.

Dividends

Plaintiff next argues that the increase in the dividends accorded Milling stockholders over Sugar common stockholders through the merger was also disproportionate and as such an indicia of unfairness (Point 4 in the Kidder Peabody Report). The dividend increase for Milling stock is from $1.20 to an estimated $1.80, a 50% rise; the dividend increase for Sugar common stock is from $2.00 to an estimated $2.48, a 24% rise. Hence Milling stockholders are getting twice as great a percentage increase in their dividends as the Sugar common stockholders.

Defendants and the district court, in rejecting this argument, put great stress on the fact that of the estimated $2.48 dividend, $1.88 is "top dollar", i.e., preferred. This fact might not be so significant in a situation where considerable earnings earmarked for dividend payment are anticipated, for then both common and preferred will be assured of dividend payment and the fact that the preferred get paid first will not matter. But, where as here, by plaintiff's own admission, the policy of the board of directors of the new corporation is going to be to retain the earnings in the business for purposes of development and growth, the fact that plaintiff has $1.88 "top dollar" gives her and others of her class the advantage of guaranteed dividend payments which, in our view, fairly justifies the percentage differential.

Plaintiff counters, however, by saying that she is not getting "top dollar", but really "sixth" dollar on her United preferred, since her preferred dividend is subordinated in payment to the interest and amortization on the outstanding loan, the interest and amortization of the debentures, and the sinking fund for redemption of the preferred. But this argument does not take away from the fact that the United cumulative preferred are in a better position, with regard to the prospect of dividend payment, than the United common.

Market Value

Plaintiff's third argument as to disproportionality is directed to the finding as to market value in Point 2 of the Kidder Peabody Report. The pre-merger figures assigned to the market value of the Sugar common and Milling stock by Kidder Peabody are $39.50 for Sugar and $49 for Milling. The estimated post-merger values traced into their equivalents in United stock are $47.80 for Sugar common and $57 for Milling. This would have resulted in a proportionate increase fair to plaintiff, and plaintiff does not contend to the contrary. What plaintiff does urge is that the estimates were unrealistic in view of what actually did occur in the market after the merger was consummated.

The estimates proved accurate for the first week after the announcement of the merger. Thereafter the average actual market value up to the time of trial of the Sugar common and Milling as traced into their equivalents in United stock increased well above the predicted levels. While the Sugar common package in its equivalents fluctuated from a low of $50 (28% increase) to a high of $65 (66⅔% increase), the Milling stock in United equivalents ranged from a low of $80 (70% increase) to a high of $116 (147% increase).

While reference to the post-merger market action is appropriate, it is equally in order to point out that hindsight is a slippery base upon which to stand in passing

judgment, particularly in matters of valuation. We only pause to note that such later market action may be influenced by many factors having little or nothing to do with the fairness of a valuation judgment previously made. Indeed, market action may be a reflection of the business community's expectations arising from the appointment of a new corporate executive or from the ascendancy of a growth-oriented management. We think the estimates made by Kidder Peabody were properly arrived at on the basis of the then relevant information. Moreover, it was not only the Milling stock equivalent in United whose value rose above the predicted increase, but Sugar common stock's package as well, resulting in an even larger premium for plaintiff than projected.

Plaintiff directs the court's attention to one other alleged indicia of unfairness of the terms of the merger. That is cash flow. She claims that, as a result of the merger, the cash flow per share of Sugar common as traced into its United equivalent has declined by 16% while that of Milling in its United equivalent has increased 112%. We feel that the same factors which have led us to conclude that the earnings per share differential was fair are equally applicable to the cash flow differential, since the cash flow charts of both corporations closely follow those of earnings and reflect most of the same significant factors.

Plaintiff's final point as to the fairness of the merger is a more general one and is directed to the exchange of Sugar common stock in part for a so-called "rare-bird" security, United non-convertible preferred. The straight preferred limits the participation of the Sugar common stockholders in the growth of the merged corporation. Plaintiff even suggests that the exchange of Sugar common for United non-convertible preferred is prohibited under New Jersey law. Outwater v. Public Service Corp., *supra.*

Putting aside the question of illegality, we do not find anything inherently unfair in a common for non-convertible preferred exchange. Although the equity par-

ticipation of Sugar common stockholders has been reduced by the transfer, the result is not a total freeze-out, since ⅓ of a share of common is also included in the package.

As to the issue of illegality, we do not think that Outwater, *supra*, stands for the proposition which plaintiff claims that it does. The vice chancellor in that case held that the provision in the agreement which required redemption of the non-convertible preferred within three years of the consummation of the merger effected a forced sale of the stockholder's equity and was therefore not permissible. The court was not concerned with the fact that the stock was non-convertible; it focused only on the redemption provision. Moreover, the factual setting in the case before us is readily distinguishable from that in Outwater in that here common as well as preferred stock has been given to the complaining stockholders. Hence, we can find no merit in plaintiff's claim that the exchange of Sugar common for non-convertible preferred was in violation of New Jersey law.

Our examination, therefore, of the merger plan as prepared by SRC, revised by Kidder Peabody, and adopted by both companies, and other factors which plaintiff would have us consider lead us to conclude that the district court was correct in deciding that the terms of the merger were fair as to plaintiff and the rest of the Sugar common stockholders. We recognize that it is most difficult to pass on the issue of fairness where the caliber of management and corporate growth potential form such a large basis for justification of the merger, but, in reaching our conclusion, we take note that Milling's tender offer for Sugar stock was not opposed by the then completely independent Sugar board of directors; that the Sugar directors, including four remaining from the independent board, one of whom owned 7300 shares of Sugar common stock worth approximately $250,000, unanimously approved the merger, and finally, that the plan was approved by independent Sugar stockholders owning more than ⅔ of all its shares.

[15]

We have reviewed plaintiff's allegation that defendants breached their fiduciary obligation by the manner in which the merger was designed and imposed and her allegation of failure on the part of defendants to disclose material information in the Sugar proxy statement used to solicit votes for the merger and find them to be without merit. We thus hold that plaintiff is not entitled to relief on her state law claim and turn to her claim based on the alleged violation of Rule 10b-5.

It is not disputed that plaintiff has the burden of proof as to the federal claim. We have already rejected in connection with the state law claim her allegations that the merger plan was unfair and that defendants have failed to discharge their fiduciary obligations toward plaintiff. It is these same assertions which are the basis for her federal claim as well. It follows, a fortiori, that plaintiff has failed to meet her burden of proof as to her 10b-5 claim. In reaching this result, we have assumed without deciding that plaintiff has stated an otherwise valid claim.

The judgment of the district court in favor of all defendants is accordingly affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

Order

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 17080

JANE LEVIN, on behalf of herself and all others similarly situated,

Plaintiff-Appellant,

and

MATILDA BURGER, *et al.,*

Common Stockholders-Intervener-Plaintiffs,

and

SAMUEL MEHLMAN, on behalf of himself and all others similarly situated,

Preferred Stockholder Intervener-Plaintiff,

v.

THE GREAT WESTERN SUGAR COMPANY, *et al.,*

Defendants.

Present: GANEY, FREEDMAN and SEITZ, *Circuit Judges.*

IT IS ORDERED that the slip opinion in the above entitled case filed February 5, 1969, be and the same is hereby amended in the following respects:

Page 4, line 1: instead of "the 1,700,000 shares of common", insert "the 1,800,000 shares of common".

Page 4, line 2: instead of "47% of the", insert "50% of the".

Page 5, line 17 from the top: after "Shortly thereafter", insert "three of", so that it reads, "Shortly thereafter three of the four . . ."

Page 5, line 32 from the top: after "by a board consisting", insert "except for one member", so that it reads, "by a board consisting, except for one member, entirely of . . ."

Page 6, line 9 from the top: instead of "owning more than ⅔ of all the shares", insert "owning 59% of all the shares".

Page 6, line 31 from the top: instead of "16, 1968, the merger", insert "15, 1968, the merger".

Page 7, line 19 from the top: delete the rest of the paragraph starting with the sentence "Plaintiff alleged and the . . ." through Page 8, line 4 from the top, and insert the following in its place, "The district court found that the burden of proof rested as a matter of New Jersey law on the defendants to show that the merger was fair. We think that under Brundage v. New Jersey Zinc, 48 N. J. 450, 226 A. 2d 585 (1967), this ruling was correct."

Page 13, line 34 from the top: instead of "Outwater v. Public Service Corp., supra", insert "Outwater v. Public Service Corp., 103 N. J. Eq. 461, 143 Atl. 729 (1928), aff'd., 104 N. J. Eq. 490, 146 Atl. 916 (1929)".

Page 14, line 37 from the top: instead of "owning more than ⅔ of all its shares", insert "owning 59% of all its shares."

BY THE COURT

COLLINS J. SEITZ,
Circuit Judge.

Date: February 20, 1969

Judgment

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 17,080

JANE LEVIN, on behalf of herself and all others similarly situated,

Appellants,

and

MATILDA BURGER, MARVIN KOCHMAN and ROSALIND KOCHMAN as tenants in common, MARVIN C. KOCHMAN, SARAH MAZER, HENRY SPIRO, EMILY SPIRO, BENITO GAGUINE, RAE GLEZER, LADDIE BOY DOG FOODS, INC., PENSION TRUST, by SEYMOUR S. KANE, Trustee, SEYMOUR KANE, Custodian for MICHAEL KANE, SEYMOUR KANE, BELLA SONNENSCHEIN, CONRAD ALPER, ELIZABETH EDLITZ, JOHN SIMMS, Trustee f/b/o ROSE GAGUINE, JOHN SIMMS, Trustee f/b/o BRUCE GAGUINE, JOHN SIMMS, Trustee f/b/o JOHN GAGUINE, LYNN S. KEDNEY and ABEL G. MESTRE,

(Intervenor-Plaintiffs),

and

SAMUEL A. MEHLMAN, on behalf of himself and all others similarly situated,

(Intervenor-Plaintiffs),

vs.

THE GREAT WESTERN SUGAR COMPANY, THE COLORADO MILLING & ELEVATOR COMPANY, GREAT WESTERN UNITED CORPORATION, ALLEN & COMPANY INCORPORATED, R. J. ADELMAN, J. LAWSON COOK, EARL F. CROSS, PALMER HOYT, A. Z. KOURI, JAMES A. KRENTLER, MARY J. MAGED, JOHN J. MARKHAM, BENJAMIN A. OXNARD, MELVIN J. ROBERTS, BEN-FLEMING SESSEL, RICHARD A. VON KAENEL, WILLIAM M. WHITE, JR., ELWOOD WHITNEY, JAMES E. SKIDMORE, ROBERT J. FISHER, LLOYD T. JENSEN.

(D. C. Civil Action No. 683-67)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Present: GANEY, FREEDMAN and SEITZ, *Circuit Judges.*

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed January 3, 1968, be, and the same is hereby affirmed. Costs taxed in favor of appellees.

ATTEST:

THOMAS F. QUINN
Clerk

February 5, 1969

APPENDIX B

Opinion of the District Court, Amendments Thereto and Judgment

[1]

Not for Publication

Opinion of the United States District Court

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Action No. 683–67

JANE LEVIN, on behalf of herself and all others similarly situated,

Plaintiffs,

vs.

THE GREAT WESTERN SUGAR COMPANY, THE COLORADO MILLING & ELEVATOR COMPANY, GREAT WESTERN UNITED CORPORATION, R. J. ADELMAN, J. LAWSON COOK, EARL F. CROSS, PALMER HOYT, A. Z. KOURI, JAMES A. KRENTLER, MARK J. MAGED, JOHN J. MARKHAM, BENJAMIN A. OXNARD, MELVIN J. ROBERTS, BEN FLEMING SESSEL, RICHARD A. VON KAENEL, WILLIAM M. WHITE, JR., ELWOOD WHITNEY, JAMES E. SKIDMORE, ROBERT J. FISHER, LLOYD T. JENSEN,

Defendants.

SAMUEL A. MEHLMAN, on behalf of himself and all others similarly situated,

Intervenors.

Appearances:

KAUFMAN, KAUFMAN & KAUFMAN, Esqs.
By: SAMUEL KAUFMAN, Esq.
Attorneys for plaintiffs.

GOLDEN, WIENSCHIENK & MANDEL, Esqs. (N.Y. Counsel)
By: RALPH WIENSCHIENK, Esq.
BERNARD ROTHMAN, Esq.
Of Counsel to plaintiffs.

SONNENSCHEIN & SHERMAN, Esqs. (N.Y. Counsel)
By: IRVING SONNENSCHEIN, Esq.
Of Counsel to plaintiffs.

UNGER & UNGER, Esqs.
By: ADRIAN M. UNGER, Esq.
Attorneys for intervenors.

STRYKER, TAMS & DILL, Esqs.
By: WILLIAM L. DILL, JR., Esq.
Attorneys for defendants Great Western Sugar Company, R. J. Adelman, Earl T. Cross, A. Z. Kouri, Benjamin Oxnard, Melvin J. Roberts, Ben Fleming Sessel, Richard A. Von Kaenel, Robert J. Fisher, and Lloyd T. Jensen.

[2]

PITNEY, HARDIN & KIPP, Esqs.
By: DONALD KIPP, Esq.
Attorneys for defendants Colorado Milling & Elevator Company, Great Western United Corporation, J. Lawson Cook, Palmer Hoyt, James A. Krentler, Mark J. Maged, John J. Markham, William M. White, Jr., Elwood Whitney, and James E. Skidmore.

COOLAHAN, *District Judge*:

The plaintiff, Jane Levin, a common stockholder of the Great Western Sugar Company[1] (hereinafter referred to as SUGAR), sues in this derivative action to enjoin a proposed merger between SUGAR, the Colorado Milling & Elevator Company (hereinafter referred to as MILLING), and the Great Western United Corporation (hereinafter referred to as UNITED, or in the alternative to enjoin SUGAR from proceeding with that proposed merger. She also seeks to have this court order MILLING to divest itself of all SUGAR stock it owns, in an orderly fashion. This court's jurisdiction is asserted in Count I of the Complaint to be grounded on Section 27(b) of the Securities Exchange Act, 15 U.S.C. §78aa, permitting suit for violations of the Act. Plaintiffs allege that the merger plan devised by defendant directors of SUGAR is unfair and is the product of a conspiracy to defraud perpetrated by them, in violation of Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j. Count II of the Complaint is based on pendant jurisdiction, and alleges common law fraud and unfairness of the merger. Count III of the Complaint is grounded on the principles of diversity jurisdiction, and repeats allegations of Counts I and II with respect to corporate defendants only.

[3]

By order of the court, dated September 27, 1967, Samuel A. Mehlman, the holder of preferred stock of SUGAR, was permitted to intervene in this suit as an additional party plaintiff. Shortly thereafter, he filed a complaint on

[1] She holds 200 shares of common stock of the Great Western Sugar Company beneficially, and 900 shares as the nominee of her investment advisor, Mr. Irving G. Brilliant.

behalf of himself and all other holders of preferred stock of SUGAR, seeking to enjoin the merger. The Mehlman Complaint—as it now stands—is similar in many respects to plaintiff Levin's, but emphasizes alleged unfairness of the proposed merger to preferred stockholders. In addition to the remedies sought by plaintiff Levin, plaintiff Mehlman seeks $3,000,000.00 in compensatory damages.

Plaintiffs' Complaints, as originally filed, included as defendants a number of banks which were alleged to have participated in the conspiracy perpetrated by other defendants, as well as Allen & Co., an investment banking concern, and also sought to have punitive damages of $2,000,000.00 assessed against all defendants, to be levied as the court saw fit. By order of the court dated October 20, 1967, all demands for punitive damages were stricken from the complaint. At the conclusion of the plaintiffs' case, the motions of the defendant banks and Allen & Co. to dismiss the action as to them, pursuant to Rule 41(b) of the Federal Rules of Civil Procedure, were granted for the reason that plaintiffs Levin and Mehlman had shown no right to relief as against those defendants.

Trial of the case having been heard by the court without a jury, the case presents two questions for determination by the court: 1) the question of alleged conspiracy by defendants to defraud the plaintiff minority shareholders, in violation of the Securities Exchange Act and common law standards of conduct; 2) the question of fairness of the plan of merger. It is the court's opinion that there was no conspiracy to defraud by any of the defendants and that

[4]

the plan of merger is fair and equitable to minority shareholders of SUGAR. The following are the court's findings

of fact with respect to the background of the merger. A discussion of the fairness question will follow.

NATURE, FINANCIAL HISTORY, AND CAPITAL STRUCTURE OF CORPORATE DEFENDANTS.

Established in 1905, SUGAR is engaged in the production of sugar and its by-products from sugar beets. It is the largest beet sugar producer in the country, accounting for about 25% of the beet sugar marketed in the United States. Total assets of SUGAR totalled approximately $125,000,000.00 as of February 28, 1967, the end of its last fiscal year, with total liabilities of approximately $31,000,000.00, leaving a net worth in the area of $93,000,000.00. SUGAR net sales over the past several years have been fairly steady, varying in 1962-66 from approximately $116,000,000.00 to $143,000,000.00 with $130,000,000.00 for the year ending February 28, 1967. SUGAR earnings for 1962-66 have been similarly steady, varying from a low of $17,400,000.00 to a high of $23,400,000.00, with a $20,900,000.00 figure for the fiscal year ending February 28, 1967.

Defendant SUGAR has presently outstanding 1,800,000 shares of common stock of which 319,557 are owned by defendant MILLING. Defendant SUGAR has also outstanding 150,000 shares of preferred stock of which 144,904 are owned by defendant MILLING. Under the Certificate of Incorporation of SUGAR, holders of preferred stock are entitled to one vote per share in elections for Directors, and holders of common stock are entitled to 1/12 vote per share. As a result, the holders of preferred stock as a class hold 50% of the aggregate voting power of the corporation

[5]

in elections for directors, notwithstanding the fact that

there are many less of such shares. On the other hand, under New Jersey statute, 14 N.J.S. §12-3, every stockholder—both common and preferred—has one *full* vote in the case of voting on a proposed merger, with the result that the common stockholders of SUGAR have, as a class, far greater say than their preferred counterparts with respect to the approval or disapproval of mergers.

MILLING, established in 1885, is principally engaged in the manufacture and sale of wheat flour and mixes, and animal feeds. It also buys and sells grains, beans, seeds, and fertilizers, and stores grains for the public in company-owned elevators. According to MILLING management, it is the fourth largest wheat flour milling company in the country, in terms of rated daily capacity to manufacture wheat flour. Total assets of MILLING totalled about $71,000,000.00 as of May 31, 1967, the end of its last fiscal year, with total liabilities of $47,000,000.00, leaving a net worth of approximately $24,000,000.00. It might be noted that $37,000,000.00 of MILLING's total assets and $37,000,000.00 of its total liabilities represent the effect of MILLING's holdings of SUGAR common and preferred stock. MILLING net sales over the past several years have been steadier than SUGAR's, varying from a low of $121,000,000.00 to a high of $131,000,000.00 in the years 1962-66, with $127,000,000.00 for the year ending May 31, 1967. MILLING earnings before depreciation, amortization, depletion, interest, and income taxes have been somewhat less steady than net sales, varying from a low of $3,500,000.00 to a high of $5,000,000.00 from 1962-66, with a $4,900,000.00 figure for the fiscal year ending February 28, 1967.

[6]

Terms of the Merger

As explained in SUGAR's August 15, 1967 proxy statement to its stockholders, the merger plan contemplates that SUGAR and MILLING will each merge with MILLING's wholly owned subsidiary,[2] UNITED, leaving UNITED as the surviving corporation of the three. According to the plan: 1) each outstanding share of MILLING will be exchanged for a common share of UNITED; 2) each publicly held outstanding common share of SUGAR shall receive one share of UNITED's new $1.88 straight preferred stock, redeemable at certain prices varying from $24.00 to $28.80 and with certain sinking fund features, and in addition will receive ⅓ share of UNITED common; 3) each publicly held outstanding preferred share of SUGAR will be exchanged for one $190.00 face amount subordinated debenture of UNITED, with interest at 6%, maturing on May 1, 1987 and subject to earlier redemption and sinking fund features; 4) the common and preferred shares of SUGAR owned by MILLING will be cancelled.

History of Merger Negotiations

The story of the SUGAR-MILLING merger proposal is in many respects the story of William White Jr., the author of the idea to merge the two companies. Mr. White is presently a director and Chairman of the Board of MILLING and is most recently a director of SUGAR. Although his family's stockholdings of SUGAR stock are not at the present time large, he is the fourth member of his family

[2] On July 15, 1967, according to SUGAR's proxy statement, MILLING owned 100 shares of UNITED common stock of a par value of $1.00 per share, constituting all of the outstanding capital stock of UNITED.

to hold a seat on the SUGAR Board of Directors, having [7]
been preceded by his father, grandfather, and great-grandfather. He presently holds one share of SUGAR stock, although his mother and his father's estate also hold SUGAR stock.

In December of 1964, Mr. White became a director of MILLING, at the unanimous request of the directors of that company. Commencing in August of 1965, he began to purchase, through a public tender offer and through other purchases, substantial quantities of MILLING stock, so that, on April 12, 1967, he held approximately 18% of that company's outstanding stock. The purchases were financed to a large extent by bank loans, which were secured in part by a pledge of the stock. In February of 1966 White conceived the idea of having MILLING make a tender offer for SUGAR stock. He was aware of the fact that 50% of the voting power of SUGAR was retained by the preferred stockholders of that company, notwithstanding the fact that they were a numerical minority, and his idea was primarily directed towards obtaining a substantial quantity of that type of stock. Having conceived the tender offer idea, he then realized that the transaction would require considerable bank financing. He and his assistant, Mr. Paul Walter, developed a formal proposal document which they circulated to several lending institutions, and finally arranged for a loan of approximately $37,000,000.00. The loan will mature on June 30, 1968; to pay it off arrangements have been made with the Prudential Insurance Company, whereby Prudential has agreed to purchase UNITED's 6⅛% Promissory Notes due June 1, 1987, in the aggregate amount of $40,000,000.00, subject to an opinion favorable towards the merger in the present case.

The tender offer was made on April 4, 1966, according to which MILLING offered to purchase from the public [8] not less than 100,000 shares of SUGAR common stock at $44.00 per share and not less than 110,000 shares of preferred stock at $190.00 per share. The minimum of 110,000 shares of SUGAR preferred represented approximately 36.5% of the voting power of SUGAR; the minimum of 100,000 shares of SUGAR common themselves represented approximately 2.75% of SUGAR control.

The public response to the MILLING tender offer exceeded that company's minimum requirements; 319,456 shares of common stock and 114,904 shares of preferred stock were obtained, thus giving MILLING a total of approximately 47% of the voting control of SUGAR.

It is clear that William White, Jr. and MILLING were not interested in having the SUGAR stock for mere investment purposes. At the time of the tender offer it was contemplated that there might eventuate a merger between SUGAR and MILLING, although there can be no question but that terms had not been set as of that date.

With voting control, for all practical purposes, assured, Mr. White and MILLING were compelled to consider how they would operate their new acquisition. It was determined that the SUGAR Board of Directors should be reduced from 13 to 11, and that 6 of the 11 should be MILLING designees. These six were defendants Adelman, Kouri, Sessel, Von Kaenel, Maged, and White, Jr. The remaining five directors of SUGAR were members of the old executive board of SUGAR: Frank Kemp, Chairman of the Board and chief executive officer of SUGAR; John Bunker, President of the company; Montgomery Dorsey, Esq., a director; William White, Sr., Mr. White Jr.'s father; and

defendant Benjamin Oxnard, Vice President in charge of sales. They were all elected directors at the SUGAR annual meeting on June 1, 1966. William White, Sr. died in [9] August of 1966, and his place on the SUGAR Board remained vacant until February of 1967.

In early September of 1966 Mr. White, Jr. met with John Bunker, SUGAR's President, at White's request, for the purpose of discussing in general term the possibility of merging SUGAR and MILLING. At that meeting White spoke in generalities of the possibility of giving the common stockholders of SUGAR a choice between: a) preferred stock; b) common stock; c) a combination of preferred and common stock of the merged company. It was Bunker's opinion that this would be difficult to implement, and that a package of preferred and common stock ought to be given to the SUGAR common stockholder, without any choice on his part to receive either all preferred or all common stock. During the discussion of the possibility of a "package deal" some mention was made—it is not clear by whom—that the package might consist of 3/10ths of a share of common and a $1.75 nonconvertible "straight" preferred stock of the merged company.

The Bunker-White merger discussions were reported to the Executive Committee of SUGAR, and it was decided that MILLING should have a formal merger plan prepared for presentation to SUGAR. In accordance with that determination, MILLING retained Standard Research Consultants, Inc., a financial consulting firm, for the purpose of having it devise a plan of merger fair to all stockholders who might be involved. Dr. Ralph E. Badger, an associate of that firm, took charge of the MILLING account.

Standard Research prepared a merger plan which it concluded was fair to all stockholders of both companies. The plan involved the exchange for each share of SUGAR common stock of a package consisting of one share of a new $1.75 preferred stock and 3/10ths of a share of a common stock of the merged company. The plan con-

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templated also that the present SUGAR preferred stockholder be given sufficient preferred shares of the merged company so that he would get approximately $190.00 in market value. The merger plan prepared by Standard Research was submitted to the members of the Executive Committee of SUGAR in early October of 1966, and then to Dillon, Read & Co., a well known investment banking concern, which since April of 1966 had been retained as a financial advisor for SUGAR. Dillon-Read's role was to evaluate the plan presented to it from the point of view of fairness to SUGAR stockholders.

After substantial consideration of the proposed plan of merger, Dillon-Read indicated that it was their feeling that the merger proposal was unfair to SUGAR stockholders, for the reason that they were not being given sufficient participation in the earnings and assets of the combined enterprise. With respect to SUGAR preferred stockholders, it was Dillon-Read's opinion that debentures rather than stock should be exchanged for the SUGAR preferred stock. Dillon-Read never prepared a written report, however, but instead expressed its convictions orally, in meetings with defendant White, Mr. Bunker, and representatives of Standard Research.

In November of 1966, acting upon MILLING's request, Standard Research developed another plan of merger, having in mind comments made by Dillon-Read as to deben-

tures for present SUGAR preferred stockholders and increased equity participation for SUGAR common stockholders. The new Standard Research Plan adopted Dillon-Read's suggestion with respect to SUGAR preferred stockholders, and would have given them a $..... debenture instead of $190.00 worth of preferred stock of the remaining corporation. Instead of 3/10ths of a share of common stock of the remaining company, the SUGAR common stockholder was offered 1/3rd of a share, plus [11] a preferred stock, now paying $1.80 per share, instead of $1.75, as had been proposed earlier. This November Standard Research plan was submitted to the SUGAR Board of Directors on November 21, 1966.

After a discussion of the plan by the Board it was determined to submit it to an investment banking firm to be chosen by the Executive Committee of SUGAR and having no prior relationship with either MILLING or SUGAR, thus precluding the retention of Dillon-Read to review the plan. The testimony indicates that the SUGAR Board simply wanted to have a fresh look at the plan. After consultation with the Bankers Trust Company, the firm of Kidder-Peabody & Co., Inc. was chosen by the Executive Committee of SUGAR for the job of evaluating the second Standard Research Plan.

Kidder-Peabody spent considerable time evaluating the November Standard Research Plan, concluding its efforts with a report presented to the full SUGAR Board of Directors at a meeting held January 20, 1967. Kidder-Peabody, in short, liked the Standard Research Plan, considering it to be fair to all SUGAR stockholders. On the other hand, it did recommend that certain improvements be made, to reflect changes in market conditions since the November

date of the Standard Research plan. Among these improvements was an increase from $1.80 to $1.87 in the dividend to be paid to SUGAR common stockholders as preferred stockholders of the remaining corporation. Other changes related to call price and redemption features. The Kidder-Peabody recommendations were approved by the SUGAR Board of Directors. In February of 1967, the revised Standard Research plan, incorporating Kidder-Peabody's recommendations, was brought to Arthur Wadsworth, Executive Vice President of Dillon-Read, by defendant Ben Fleming Sessel, a director of SUGAR elected in June of

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1966 as a William White, Jr. designee, for the purpose of ascertaining whether Dillon-Read could, as a result of the Kidder-Peabody changes in the plan, now say that it was fair to the stockholders of SUGAR. There is some dispute on the testimony at this point, but it appears that Mr. Wadsworth indicated to Mr. Sessel the fact that it could not say its reservations had been removed or express an opinion as to the plan's fairness without a new analysis, taking into account, among other things, various developments which had taken place since its original study.[3]

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[3] This is confirmed by Mr. Wadsworth's characterization of the statement in SUGAR's proxy statement of August 15, 1967 regarding Dillon-Read's February, 1967 role as a "fair statement". That statement, at page 9 of the proxy statement, DCM 5, read:

> Before final action was taken by the Board of Directors of Great Western on the terms of the Merger described in this Proxy Statement, certain Directors of Great Western discussed the proposal with representatives of Dillon, Read with a view to ascertaining whether that firm was prepared to give its opinion with respect to the fairness of the proposal. After a preliminary review, Dillon, Read orally advised that it could not say that its reservations had been removed or express an opinion as to the fairness of the plan without a new analysis, taking into account, among other things, various developments which had taken place since its original study.

Also in February of 1967, Directors Kemp, Bunker, and Dorsey resigned their positions with SUGAR. Bunker went on to become President of the Holly Sugar Corp., a competitor of SUGAR's; Kemp apparently retired from commercial enterprise, since he was 77 years of age. In their stead, and also to replace William White, Sr., who had died in August of 1966, the Board of Directors of SUGAR elected, on February 23, 1967, defendants Cross, Fisher, Jensen, and Roberts as Directors. Cross had been President and Director of MILLING; on February 23, 1967 he was granted a leave of absence by MILLING and was elected President and Chief Executive Officer of SUGAR, remaining as a director of MILLING.

During the period from January to April of 1967, Kidder-

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Peabody continued to work on the plan of merger, finalizing and bringing up to date the details thereof. By April of 1967 it was of the conviction that the debentures to be exchanged for SUGAR preferred stock should have a principal amount of $190.00 and bear 6% interest, in order to give it a desired market value of $179.00. In January, by way of contrast, it had suggested that either a $195.00 principal amount with 6% interest, or a $179.00 principal amount with 6¾% interest would result in a $179.00 market value. Kidder-Peabody also apparently suggested to SUGAR the propriety of raising the dividend on the new preferred stock to be given to SUGAR common stockholders from $1.87 to $1.88. In addition, it developed within this period details of various specific provisions, including those of its recommended sinking fund for the new preferred stock to be issued to the SUGAR common stockholders. Based on Kidder-Peabody recommendations, SUGAR had its counsel prepare the form of the final

merger agreement, which was submitted to SUGAR's Board of Directors on April 11, 1967. After discussion on the 11th, the plan of merger was approved by the Board on April 12, 1967.

It was determined by the SUGAR Board that a special meeting of shareholders of that corporation should be held on September 15, 1967 for the purpose of considering and acting upon the proposed merger. Proxy materials, dated August 15, 1967, presented to the SUGAR stockholders a full, fair, and complete disclosure of all information material to their consideration of the proposed merger. The SUGAR stockholder meeting was held, as scheduled, on September 15. There were 1,579,535 votes cast in favor of the merger, and 94,317 votes opposed. MILLING ownership of SUGAR shares entitled it to cast only 434,461 votes or 22% of the total vote. The stockholder approval was [14] by 94.3% of the shares which were voted at the meeting, and by 92.3% of the independent (non-MILLING) stockholders.

CONCLUSIONS OF LAW WITH RESPECT TO FRAUD

As has been adverted to earlier, plaintiffs charge defendants with both common law fraud, and fraud as proscribed by the Securities Exchange Act of 1934, specifically section 10 (b) of that Act, 15 U.S.C. 78j. It is elemental that in the case of both types of fraud, the plaintiff, as in any other civil action, has the burden of proof. It is the court's view that neither plaintiff has sustained that burden in the present case.

Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j, makes it unlawful to

use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule X-10B-5 of the Securities Exchange Commission, promulgated under the authority of Section 10(b), makes it unlawful for any person:

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

It is clear that Rule X-10B-5, a child of Section 10(b) of the Exchange Act, is also subject to the conditions laid out in that section. One such condition is that the manipulative or deceptive device be "in connection with the purchase or sale of any security . . . ." It is readily apparent from the facts of the present case that even were there fraud on

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the part of defendants, it would not be actionable under Section 10(b). The court is aware of the fact that the

bounds of "connection" with the purchase or sale of securities has been liberally interpreted in decisions considering the question, but is of the opinion that the bounds have not been extended as far as the plaintiffs would apparently have them connected here.

That fact is not, however, necessary for the court's decision. It is the court's view that there was no deception, misrepresentation, or any other type of fraud in the present case. The defendant directors acted in their own interests, but as reasonable businessmen aware of their obligations to SUGAR. In good faith they sought a merger that would be fair to everyone concerned. They consulted reputable financial sources in order to obtain a fair plan of merger. The credentials of Standard Research Consultants and Kidder-Peabody are impeccable. Changes in the merger terms were made throughout the time of preparation of the final plan, with the aim of maximizing fairness to all concerned. Irrespective of their success in arriving at a fair plan (which is yet to be considered), it is clear that good faith was the motto throughout.

Plaintiffs' suggestions as to collusion between William White, Jr. and Dr. Ralph Badger of Standard Research in arriving at the first Standard Research plan are not well founded. They attribute the similarity between the exchange package for SUGAR common stockholders mentioned by William White, Jr. to John Bunker, SUGAR's President, and the package later arrived at by Dr. Badger, to malevolence, arguing strenuously that White told Dr. Badger what to put in his plan. It is the court's view that the similarity results either from coincidence or from the fact that Dr. Badger—if Mr. White Jr. did in fact mention

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to Dr. Badger the same package deal he had discussed with

Mr. Bunker—thought the idea to be fair and equitable. The court is convinced of Dr. Badger's honesty and of the fact that he made a good faith effort to devise a fair plan of merger.

Plaintiffs also attribute malevolence to defendants' retention of Kidder-Peabody for, and dismissal of Dillon-Read from, evaluation of the merger proposals. Dillon-Read, they suggest, was removed from the project because they had refused to "rubber stamp" defendants' unfair plan of merger. This was not the case. The evidence indicates that the retention of Kidder-Peabody was for the purpose of getting a "fresh look" at the new Standard Research November plan, and for no other purpose.

Plaintiffs' assertions with respect to common law fraud must fail for the same reasons. As stated in *Schoharie County Co-op. Dairies, Inc.* v. *Eisenstein*, 22 N.J. Super 503 (App. Div. 1952), common law fraud in New Jersey requires:

> (1) that the person sued made false representations to the plaintiff as to present or past material facts,
>
> (2) that he knew they were false when made,
>
> (3) that he made them intending the plaintiff to act upon them,
>
> (4) that the plaintiff did act in reliance upon them, and
>
> (5) that damage resulted therefrom.

It is clear in the present case that there were no false representations made to plaintiffs, or to anyone else.

Interpreting plaintiffs' common law fraud claim as one for defendants' breach of their fiduciary duty to the cor-

poration does not assist plaintiffs either. The fiduciary duty required of directors of a corporation does not require—as in other fiduciary contexts—that they be completely barred from making profit themselves. A director can deal with his company, for example. The standard for determining breach of fiduciary duty in the present context is to determine—as in the case of a sale by a [17]
director of, say, property to his company—whether the company could have gotten a better deal on the marketplace. In the present context, the "marketplace" standard is the standard of "arms-length negotiation" between the director and his company, and it is to be determined, in assessing whether a director has breached his fiduciary duty, whether the merger plan arrived at in the present case approximates one that would have been arrived at through "arms-length negotiation". Because it is the court's view that the final merger plan was of a similar nature to what would have likely resulted in the merger "marketplace," it is also the court's view that the defendant directors have not violated their fiduciary duties to SUGAR. It is obvious that the foregoing discussion neatly leads one to inquire as to fairness, and it is essential that this be the next point considered.

Findings of Law With Respect to Fairness

There can be no question but that a merger may be enjoined if it is not fair and equitable to all concerned. See *Brundage* v. *New Jersey Zinc Co.*, 48 N.J. 450 (1967); *Outwater* v. *Public Serv. Corp.*, 103 N.J. Eq. 461 (Ch. 1928), *aff'd*, 104 N.J. Eq. 490 (E. & A. 1929); *Bingham* v. *Savings Inv. & Trust Co.*, 101 N.J. Eq. 413 (Ch. 1927). The only

real question as to the law left in this case, then, concerns the matter of the burden of proof of showing fairness or unfairness. Defendants contend that the plaintiffs must bear that burden, in view of the fact that the overwhelming majority of independent (non-MILLING) stockholders of SUGAR voted in favor of the merger (92.3%).

The *Brundage* case, *supra,* appears to hold to the contrary. That case was a derivative suit by a minority stockholder of the New Jersey Zinc Company to enjoin a pro-

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posed merger between that company and Gulf & Western Industries, Inc. At the time of the formulation of the merger plan, Gulf & Western owned 57% of Zinc's capital stock, and had three designees on the Zinc Board of Directors (out of 16). Defendants there argued that the overwhelming shareholder approval (91.2% of independent, non-Gulf & Western, stockholders) of the merger shifted the burden of proof, which they recognized as originally reposing in them,[4] to the plaintiffs.

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[4] There can be no question but that, at New Jersey law, the burden of proof, in the case of interlocking directorates, resides in those attempting to sustain the fairness of the merger. See *Brundage, supra,* at 475-76:

> In Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 41 S.Ct. 209, 65 L.Ed. 425 (1921), the Supreme Court expressed the following views to which we readily subscribe:
>
> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between the director and his corporation; and where the fairness of such a transaction is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is

Rejecting that argument, the New Jersey Supreme Court pointed to the *Outwater* case, *supra,* and noted that in that case the Vice Chancellor

> enjoined, as unfair to minority stockholders, a proposed merger between Public Service and several affiliated companies in which it was the majority stockholder. In the course of his opinion, the Vice Chancellor pointed to the burden on the majority of showing fairness and noted that the judgment as to fairness was "not to be influenced by the heavy vote of approval, as it otherwise would be if the vote were independent."

The *Brundage* court later explained the reasoning behind the New Jersey rule:

> **[19]**
> As holder of the majority stock in Zinc on whose board of directors it was represented it had affirmative fiduciary responsibilities to Zinc's minority stockholders. Its sources of information as to the fairness of the merger terms were undoubtedly more intimate and far greater than those available to the thousands of Zinc minority stockholders who relied heavily, if not entirely, on management's recommendation that the merger was in the best interests of "New Jersey Zinc and all of its Stockholders."

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founded in soundest morality, and we now add in the soundest business policy. Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588, 23 L.Ed. 328, [329, 330, 3 Mor. Min. Rep. 688]; Thomas v. Brownville [Ft. K & P.R.] Co., 109 U.S. 522, 3 Sup. Ct. 315, 27 L.Ed. 1018; Wardell v. [Union P.R.] Co., 103 U.S. 651, 26 L.Ed. 509 [511, 7 Mor. Min. Rep. 144]; Corsicana National Bank v. Johnson, 251 U.S. 68, 90, 40 Sup. Ct. 82, 64 L.Ed. 141 [155]."

The court then concluded that the burden of establishing fairness rested throughout the proceeding on those seeking to uphold the merger.

Defendants in the present proceedings attempt to distinguish *Brundage* by pointing out that whereas in that case Gulf & Western owned 57% of the capital stock of New Jersey Zinc, MILLING shareholdings of SUGAR stock in the present case entitled it to only 22% of the votes at the SUGAR shareholders meeting which approved the merger. This reasoning is misplaced. Although MILLING had only 22% of the votes required to put over the merger with SUGAR, it had, as has been noted earlier, over 47% of the voting control of SUGAR under ordinary circumstances, and in fact exercised that voting control so as to place 11 of its nominees on MILLING's 12 man Board of Directors. In the *Brundage* case, where only 3 out of 16 members of the Zinc Board were Gulf & Western nominees, the court based its decision on the relative disparity between the information available to the Gulf & Western interests and the independent minority shareholders of the Zinc company. That disparity is so much greater in the present case.

Nor can defendants here rely, as they appear to be doing to some extent, on the fact that in *Brundage* the independent stockholders were in the minority in terms of the total number of shares of the corporation, whereas in the present case the independent stockholders have in

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theory 53% control for all corporate purposes. Even ignoring the fact of stockholdings of SUGAR stock by present SUGAR directors and their relatives, the court can take judicial notice of the fact that in virtually all corporate settings 47% control is as good as 57% control, since cor-

porate shareholders are by and large disorganized and tend to follow management's advice, which is due in large measure, to their lack of access to information which would enable them to form an independent opinion as to the merits of the particular corporate decision to be made. These are precisely the criteria employed in *Brundage,* and the holding of that case is dispositive of the burden of proof question in the present case. The defendants will have the burden of proof of showing that the plan of merger devised by them was not unfair or inequitable.

Was the Plan of Merger Unfair to SUGAR Preferred Stockholders?

As has been adverted to earlier, the final plan of merger contemplates that the public (non-MILLING) holders of the outstanding $100.00 7% cumulative preferred stock of SUGAR will receive one $190.00 principal amount 6% subordinated sinking fund debenture of UNITED for each share of SUGAR preferred stock. The court finds no difficulty whatsoever in concluding that the plan of merger is not unfair to SUGAR preferred stockholders.

The holder of each share of SUGAR preferred stock will receive $11.40 in interest on the new debenture of UNITED; as a preferred stockholder of SUGAR he received only a $7.00 dividend. This represents an increase of 62.8%, hardly unfair. In addition, this dividend is "first dollar" money, and will be paid before either UNITED preferred or common stockholders receive dividend payment.

Based on testimony brought out at trial, there is every

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indication that the present SUGAR preferred stockholder will also receive a substantial market premium. It is, of

course, difficult to estimate what the market value of the SUGAR preferred stock would be today were it not for the imminence of the proposed merger, and to estimate the market price at which UNITED debentures will open. Yet, the testimony in the case establishes to the court's satisfaction that the SUGAR preferred stockholder will receive a market premium over what has been estimated as the "intrinsic value" of his stock of from 20 to 35%,[5] hardly unfair. It might be pointed out, in addition, that commencing May 1, 1973, UNITED will redeem 6% of the debentures yearly, at a price of $190.00, a price which compares favorably with the April, 1967, price for SUGAR preferred stock (around 169), and the September, 1967, price (158, based on fragmentary sales),[6] both of which prices, it must be noted, themselves reflect price buoyancy as a result of the imminence of merger.

Plaintiff Mehlman emphasizes the fact that the UNITED debentures to be issued in exchange for the SUGAR preferred stock will be subordinated to the debt incurred by MILLING in order to acquire the SUGAR stock. It is also

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[5] See Tr. at 1693 (Albert H. Gordon—redirect); Tr. at 2039 (David A. Goldberg—direct).

[6] A total of 480 shares of preferred stock of SUGAR were traded in April of 1967, at a price of around 169; a total of 420 shares were traded in May, at a price of around 165; a total of around 810 shares were traded in June at a price of around 157; a total of 20 shares were traded in July, at a price of 160; a total of 330 shares were traded in August, at a price of around 157; a total of 120 shares were traded in September, at a price of around 158; a total of 50 shares were traded in October of 1967, at a price of around 150.

April of 1967, of course, was the date of the approval by the SUGAR Board of Directors of the plan of merger. September of 1967 was the date of the approval by the shareholders of SUGAR of the plan of merger.

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his position that the merger plan is unfair to his class of stockholders because there are no limitations in the Certificate of Incorporation of UNITED, or anywhere, which limit further debt which can be piled upon his debentures. That the debentures to be given to the SUGAR preferred stockholders will be subordinated to the debt incurred by MILLING is clear. But it is equally clear that the coverage on that debt is so ample at the present time and the foreseeable future that the existence of senior debt should be no problem whatsoever. Nor is the fact that additional senior debt can be placed above the UNITED debentures particularly shocking. This represents no departure from plaintiff Mehlman's present position as a SUGAR preferred stockholder. For, there is nothing in the SUGAR Articles of Incorporation, or elsewhere, which would prevent the Board of Directors of that corporation from placing senior debt above Mr. Mehlman's stock.

Nor can it be argued that the merger plan is unfair to the SUGAR preferred stockholders because they have lost their right to vote. That right is of minor significance in the present case because 1) SUGAR does not have cumulative voting, and 2) MILLING already owns 76% of SUGAR preferred stock and approximately 47% of overall voting control. Any minor loss to the SUGAR preferred stockholder in this regard is made up for, in any event, by gains—already mentioned—with respect to income and market value. On the whole, it is the court's opinion that the plan of merger is not unfair to plaintiff Mehlman and the class of stock he represents, and that the defendants have sufficiently proven this fact.

Was the Plan of Merger Unfair to SUGAR Common Stockholders?

The question of fairness to plaintiff Levin and the class [23] of stockholders she represents is a somewhat more difficult question, but it is the court's conclusion that the plan of merger is fair to SUGAR common stockholders also.

The terms of merger, as noted earlier, provide that the present SUGAR common stockholder will receive in exchange for each share of SUGAR common stock one share of a new $1.88 UNITED preferred stock plus ⅓rd share of a UNITED common stock.

As a result of that exchange, several changes in his situation will likely occur. One prominent change is that he will receive an increase in stock dividends from $2.00 to $2.48, assuming a UNITED common dividend of $1.80 (the projected figure, and, incidentally, the maximum payable according to the terms of the Prudential loan agreement). Of this $2.48, $1.88 will be a preferred stock dividend, and "first money"; the remaining $.60 will come from the ⅓rd share of SUGAR common. The total increase in dividends for the SUGAR common stockholder will be 24%.

Another result of the exchange will be that the present SUGAR common stockholder will have somewhat less earnings attributable to his stockholdings. In the year ending February 28, 1967, his one share of common stock earned $4.57 per share; had the merger been completed before 1967, his new package of preferred and common stock would have earned $4.04. This decrease is attributable to the fact that the former SUGAR common stockholder will, according to the merger plan, be given a fixed-income security—the $1.88 non-participating non-converti-

ble preferred stock. As a result, earnings of UNITED which exceed the amount of money required to pay off $1.88 to each of its preferred stockholders will not be reflected in their earnings per share figures (except to the extent necessary to attribute earnings to the 1/3rd share of UNITED also to be held by former SUGAR common

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stockholders), whereas SUGAR earnings in excess of actual payments by way of dividends to their common stockholders were fully reflected in earnings per share figures. As a result of the decrease in the earnings package for present SUGAR common stockholders, and of the fact that present MILLING stockholders will receive one full share of UNITED common in exchange for each MILLING stock, the earnings per share to MILLING stockholders will increase. In the year ending May 31, 1967, the MILLING stockholder earned $3.52 per share; had the merger been consummated prior to 1966 he would have, as a common stockholder of UNITED, earned $10.28 per share.

It is the court's view that this disparity in earnings between stockholders of MILLING and SUGAR is of little or no importance. Although earnings per share may be a significant figure when comparing the quality of stock of two different corporations, it would seem that the figure's importance is very limited when contrasting the relative standing of stockholders of the same corporation. What is important here is what is actually paid out by way of dividends; in that respect, as has been already noted, the merger plan is fair to all concerned. Although it could be suggested that the decrease in earnings per share(s) which the present SUGAR stockholder will face as a result of the merger is in fact an indication that the quality

of his stockholdings will decrease (since SUGAR and UNITED are, indeed, two different corporations), it is the court's view that this decrease is certainly not sufficient to warrant a determination that the proposed merger is unfair. Firstly, the decrease is relatively small ($4.57 to $4.04); secondly, it is misleading to point to the decrease alone—it must be realized that $1.88 of that $4.04 is represented by the fixed income preferred stock of UNITED [25] which the SUGAR common stockholder will receive.

Market value is the next major guide to be considered in evaluating the fairness of the merger proposal to SUGAR common stockholders. Once again, the problem of estimating "intrinsic" value of stock, and of estimating the market price of stock when it is finally issued, arises. It is the court's view, based on the evidence before it, that the present SUGAR common stockholder will receive a substantial market premium in the exchange as contemplated, and that the terms of the exchange are not unfair to him.

Dr. Ralph Badger of Standard Research Consultants, in many respects the author of the final plan of merger, testified that it was his opinion that the "intrinsic value" of SUGAR common stock was $39.00 per share, and that, as a result of the merger, the SUGAR common stockholder would receive a package with a value of $47.00 on the market place (approximately a 20% increase). The $47.00

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[7] Although it could be argued that this dismissal of the comparative (between SUGAR and MILLING common shareholders) earnings per share figures in the UNITED corporation is valid only so long as the Prudential loan, imposing a $1.80 per share dividend limit on UNITED common stock, is still outstanding, it might be pointed out that this loan agreement will be in effect until at least 1987, and that by that time the UNITED preferred stock may very well have been either mostly or totally redeemed.

figure was arrived at by estimating the value of the UNITED preferred stock at $28.00, and the value of the UNITED common stock at $57.00. Since the SUGAR common stockholder would receive one full share of UNITED preferred, plus ⅓rd share of UNITED common, in exchange for his stock, the projected market value to him would be $28.00 + $19.00 [$57.00 + 3] = $47.00.

Dr. Badger's $57.00 figure for the UNITED common stock was arrived at by employing an earnings multiple [26] of 8½ for the new company. Plaintiffs dispute that figure, suggesting that a 12 or 13 earnings multiple would be more appropriate, since that is the multiple currently enjoyed by present MILLING stockholders, and it is defendants' position that one of the benefits of the merger to SUGAR stockholders is the "aura of growth" brought to the merger by MILLING management, which "aura of growth," if it in fact exists, would likely be reflected in a high earnings multiple. Projecting a 12 or 13 earnings multiple, plaintiffs suggest that the value of the package to SUGAR stockholders would be in the area of $51.00 to $58.80. This figure is arrived at by taking a $26.00 to $28.00 estimated value for the UNITED preferred stock and adding to it ⅓rd of the approximate $80.00 value for the UNITED common stock which an earnings multiple of 12 would present. It is the court's view that this higher figure for the value of the package to present SUGAR common stockholders would in fact increase the likelihood of a fair merger, since it would give each stockholder a 30 to 50% market premium.

The discussion cannot, however, end at this point. To end it here would indeed do injustice to the major thrust of plaintiff Levin's complaint, that although there is a substantial market premium to the SUGAR common stock-

holder, the premium offered to him is not as large as the premium that the MILLING stockholder will receive as a result of the plan of merger. Using the 12 to 13 earnings multiple, which plaintiff suggests is appropriate, the market price of the UNITED common stock will likely be around 80, as has already been noted. As a result of the fact that one UNITED common stock is to be exchanged for each MILLING share, the present MILLING stockholder will receive a stock worth $80.00 in exchange for one with an "intrinsic value" of $47.00 per share, as estimated by Dr. [27]
Badger, defendants' financial advisor. Plaintiff Levin wishes to contrast the somewhat larger percentile market premium which the MILLING stockholder will receive with that to be given the SUGAR common stockholder.

It is the court's view that this type of analysis is fallacious. There is nothing in the requirement that a merger be fair and equitable that requires absolute equality in the treatment to be accorded to all stockholders. As a practical matter, such total equality is impossible. The court's role in assessing the fairness of a plan of merger is to consider whether the plan is to the slightest extent unconscionable or calculated to be discriminatory. The court finds that this was not the case. A vast majority of the independent common stockholders of SUGAR voted in favor of the merger. Their decision that the plan was fair may be weighed along with other circumstances, in assessing fairness, *Brundage* v. *New Jersey Zinc, supra* at 477, and the court will not, considering the totality of circumstances presented before it, disturb that decision.

The many experts and other witnesses who appeared before the court in this case and gave their analysis of the

probabilities of the market based their opinions on many analytical techniques. It is the court's view that it is fair to state that all forms of stock market analysis are not exact sciences, but, like all forms of statistical projection, involve the study of probabilities alone. Allowance must be made for errors in interpretation and judgment as well as the unexpected developments which take place from day to day. Considering the quality of proof adduced by the respective parties in the present case, it is the court's view that witnesses presented by the defendants—representatives of among the most well-known and respected financial

[28]

houses—were by far the most convincing. Plaintiffs' witnesses, by and large academicians and others not intimately related to practical finance, nor ever involved in any merger proceedings, convinced the court only of their sincerity and general classroom-type of analysis.

Qualifications of Directors

At a very late stage during the trial of the case, plaintiff Levin attempted to challenge the validity of the merger by alleging that a number of the MILLING designees on the Board of SUGAR were not validly elected to their position, since they were not, as required by New Jersey statute, 14 N.J.S. 7-2, bona fide shareholders of SUGAR at the time of their election. It was the court's view at that time, and continues to be the court's view, that this is not an issue in the case. It was not raised in the plaintiff's complaint, and was raised at such a late stage in the proceedings that to permit it to be made an issue would certainly be prejudicial to defendants.

In any event, however, there is every indication that plaintiff Levin's allegation is not well-founded. She sug-

gests that defendants Maged, White, Adelman, Von Kaenel, Kouri, and Sessel were not the beneficial owners of any SUGAR shares at the time of their election on June 1, 1966, but were merely record owners. This, she suggests, prevents them from being bona fide directors. It is the court's view that that suggestion does not derive from an accurate reading of the New Jersey cases. As was stated in the case of *In the Matter of Election of St. Lawrence Steamboat Co.*, 44 N.J.L. 529 (Sup. Ct. 1882):

> Independent of the statute, a person might be a director of a corporation without being a stockholder. The statute is guardedly expressed. It prescribes as [29]
> the qualification of a director, that he shall be a *bona fide* holder of stock. A stockholder may have purchased stock with a view to becoming a director, or have obtained it by gift, or he may hold it upon a trust, and be qualified to be a director. If the stock was legally issued, and is not the property of the corporation, and the legal title is in him, he is, *prima facie*, capable of being a director, and his right to be a director, in virtue of his legal title to such stock, can be impeached only by showing that title was put in him colorably, with a view to qualify him to be a director for some dishonest purpose, in furtherance of some fraudulent scheme touching the organization or control of the company, or to carry into effect some fraudulent arrangement with the company . . . .

As the court has noted earlier, there was no dishonesty in the present case, and no scheme to defraud. As a result, the *St. Lawrence Steamboat* case is dispositive, and the quali-

fications of directors Maged, White, Adelman, Kouri, Sessel, and Von Kænel to sit as SUGAR directors cannot be challenged.

Plaintiff suggests, in addition, that defendant Von Kænel was not even a record holder of SUGAR stock at the time of his election. Particular reliance is placed on a statement made in his deposition that he first "acquired" SUGAR stock in July of 1966. In view of the fact that it is totally unclear whether Mr. Von Kænel had in mind record or beneficial "acquisition" of the stock, no reliance can be placed on that statement whatsoever. The court certainly can take judicial notice of the fact that popular lexicography generally attributes to the word "acquire" a physical holding of the item received; this would be totally consistent with record ownership on June 1, 1966 and beneficial ownership some time thereafter, which, as has been noted above, is totally unobjectionable in the absence of fraud or dishonesty.

It is the court's conclusion that the facts of the present case indicate no conspiracy to defraud on the part of

[30]

defendants, and that the merger between MILLING and SUGAR, through the instrumentality of UNITED, will not be enjoined.

Let an appropriate order be submitted.

Order Amending Opinion

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

CIVIL ACTION No. 683-67

JANE LEVIN, on behalf of herself and all others similarly situated,

Plaintiffs,

vs.

THE GREAT WESTERN SUGAR COMPANY, et al.,

Defendants.

SAMUEL A. MEHLMAN, on behalf of himself and all others similarly situated,

Intervenors.

It is ORDERED that the Opinion filed in the above entitled matter on December 28, 1967, be and the same hereby is amended as follows:

Page 2—Line 3—the word "derivative" should read "class."

Page 10—Line 2—the word "preferred" should be deleted.

Page 10—Line 3—the number "$190.00" should be replaced with "$173.50."

Page 10—Line 27—the number "$190.00" should be replaced with "$173.50."

Page 10—Line 28—the word "preferred" should be deleted.

Page 17—Line 28—the word "derivative" should be deleted.

Page 19—Line 23—the word "MILLING's" should read "SUGAR's."

Page 24—Line 11—the number "$10.28" should be replaced with "$6.60."

On page 23, line 12, and page 25, footnote 7 of the opinion, reference was made to the fact that the Prudential loan agreement imposes a maximum of $1.80 on the amount of dividend UNITED will be able to pay out on its common shares. This was inaccurate. The $1.80 figure refers to the maximum under the bank loans, soon to be replaced, whereas the maximum under the Prudential loan is determined by a formula dependent on consolidated net earnings of UNITED. The $1.80 figure, however, still remains as the projected figure for the earnings payout on UNITED common shares, and the fact that that projection is not enforced by the Prudential agreement means little in the total circumstances of the case.

DATED: January 11, 1968.

JAMES A. COOLAHAN
United States District Judge.

Judgment

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Action No. 683-67

JANE LEVIN, on behalf of herself and all others similarly situated,

Plaintiffs,

—and—

SAMUEL A. MEHLMAN, on behalf of himself and all others similarly situated,

Plaintiffs-Intervenors,

—vs.—

THE GREAT WESTERN SUGAR COMPANY, et al.,

Defendants.

This action having come on for trial before the Court, without a jury, and the Court having considered all the testimony and other evidence presented in this matter and the arguments of counsel and having rendered its opinion setting forth its findings of fact and conclusions of law and for the reasons expressed in said opinion,

IT IS, on this 2nd day of January, 1968, ORDERED that this action be and it hereby is dismissed and that final

judgment be and it hereby is entered in favor of the defendants The Great Western Sugar Company, R. J. Adelman, Earl F. Cross, A. Z. Kouri, Benjamin A. Oxnard, Melvin J. Roberts, Ben-Fleming Sessel, Richard A. Von Kaenel, Robert J. Fisher and Lloyd T. Jensen; and defendants The Colorado Milling & Elevator Company, Great Western United Corporation, J. Lawson Cook, Palmer Hoyt, James A. Krentler, Mark J. Maged, John J. Markham, William M. White, Jr., Elwood Whitney and James E. Skidmore and each of them, without costs.

JAMES A. COOLAHAN
U.S.D.J.

APPENDIX C

Statutes and Rules Involved

The relevant provisions of Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. Sec. 78j(b), provide:

"It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The relevant provisions of S.E.C. Rule 10b-5 (17 CFR Sec. 240.10b-5), provide:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."